# BUILDING AMERICA: CHALLENGES FOR SMALL CONSTRUCTION CONTRACTORS

## HEARING

BEFORE THE

SUBCOMMITTEE ON CONTRACTING AND TECHNOLOGY

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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# BUILDING AMERICA: CHALLENGES FOR SMALL CONSTRUCTION CONTRACTORS

**THURSDAY, MAY 23, 2013**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON CONTRACTING AND TECHNOLOGY,
*Washington, DC.*

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Richard Hanna [chairman of the Subcommittee] presiding.

Present: Representatives Hanna, Bentivolio, Clarke, and Meng.

Chairman HANNA. Morning, everyone.

This hearing will come to order. We are here today to talk about the role that small businesses play in construction contracting and how Congress can act to increase the opportunities for small businesses. To that end, we are going to talk about four different problems facing small businesses in construction and potential legislative solutions to each of these.

I am familiar with many of these issues we will discuss today because of my personal experience as a general contractor. Over the course of 30 years in private business, I have grown a small business where I worked alone, employed over 450 people over time, and successfully completed over 3,000 big and small jobs in upstate New York.

Given that experience, I know how important small business construction contracting is. It is an industry where a small business can grow to a large business. Construction contracting builds communities. As you will hear today from our private sector witnesses, Federal construction contracting plays a big part in creating these opportunities. In the Federal space, construction and architecture and engineering, A&E, contracting represents about 1 in every 6 prime contract dollars awarded to small businesses. That amounted to over $17 billion last year alone.

However, as construction projects get larger, it becomes harder for small businesses to obtain the necessary bonding to bid these projects. In these cases, they sometimes turn to disreputable sureties who issue worthless bonds that place taxpayers at risk. That is why I am the sponsor of H.R. 776, which we will discuss today. This is a no-cost bill that makes it easier for small businesses to get legitimate bonds and that makes sure that all bonds are worth more than the paper on which they are written. The Small Business Administration is joining us to discuss making bonds accessible to small firms. Sometimes the way we buy construction A&E is as important to small businesses as what we are buying.

So we are going to also discuss two procurement methodologies: First, reverse auctions, which may work for commodities but I question whether it is appropriate for construction-related services; the second methodology is the two phase approach to design build contracts. Given the cost of bidding for design work, the two-phased approach allows more small businesses to compete, yet it isn't always used properly. The Corps of Engineers have looked at both methodologies. And I look forward to hearing more about their findings.

Construction contracting more than almost any other industry creates opportunities for small businesses and subcontractors. For that reason, the law requires that prime contractors and large subcontractors track and report how they use small business subcontractors. We give large businesses credit toward their subcontracting goals if they use small businesses at their first tier of subcontracting but not small businesses at the second tier of contracting. Today we are going to examine whether we can create more opportunities for small businesses if we are allowed to count these lower tier subcontractors.

I look forward to a good conversation today so that we can give the subcommittee recommendations on how to proceed legislatively. I want to thank you all for your testimony today and your time. And I would like to yield to the ranking member.

Ms. MENG. Thank you, Mr. Chairman.

And thank you all for being here this morning. As you know, recently, the economy has showed promising signs of recovery, adding 6.8 million jobs private sector jobs in the past 3 years with more than 800,000 being created in the last 4 months alone. Consumer confidence has reached a 6-year high and the stock market has set new records. In many regards, it is small businesses leading the way as they increase hiring and expansion. A key part of this resurgence is the construction sector, which is dominated by small firms with less than 20 employees. In fact, the unemployment rate for construction workers fell to the lowest April level in 5 years as contractors added more than 150,000 employees in the past year.

This recovery appears to be fairly broad-based, as nearly all types of construction specialties are growing, with architectural and engineering services employment up 2 percent from a year earlier. While this is welcomed progress, more work needs to be done. The unemployment rate in the construction industry remains at 17 percent, more than double the national rate. And while jobs have been added recently, it masks the reality that employment in the sector remains stagnant at 1996 levels.

The reason is clear: Construction spending—both private and public—has decreased dramatically over the last 5 years, with the recent sequester only adding to this challenge.

But declining spending is not the only hurdle this sector faces. Winning Federal construction work continues to be difficult for many small firms. Contracting bundling continues to be among the largest obstacles, as last year more than 150 contracts were consolidated, worth over $260 billion. As a result, many small firms missed out on lucrative opportunities, opportunities that could have been the difference between staying in business and closing. By bundling large contracts such as these, the government effec-

tively shuts out many smaller firms from competing for work that they have the skills and expertise to perform. Splitting these megacontracts into smaller pieces would enable more construction firms to participate in these projects. By doing so, the government would avail itself of more qualified companies and the high quality craftsmanship they bring to the table.

Another challenge that small construction firms face is receiving a surety bond which is required by the government and guarantees contractor performance. While the SBA operates a program to fill this gap, it is failing to achieve its full potential. This is due to a lack of consistency with industry practices and a failure to market this program effectively to construction companies. These concerns, as well as the fee increases required to fund the program, are preventing small firms from competing for Federal construction contracts. While bundling and bonding are the most notable obstacles to a small firm's participation in Federal construction projects, other issues are also impeding their involvement. New innovative procurement methods, such as the two-step design build process and reverse auctions, may be well suited for a certain contracts but have to be evaluated for their impact on small businesses specifically. After all, it is important to ensure that the odds are not stacked against smaller firms and that, instead, there is a level playing field for them to compete fairly for a contract.

During today's hearing, I am looking forward to hearing from both agency officials and industry experts on these issues. Making certain that small construction and A&E firms can fully compete in the Federal marketplace is crucial not just for them but for the country, as this sector is literally the foundation for so much of our Nation's economy.

In light of the sequestration, declining private sector investment, and reductions in State and local infrastructure investments, Federal contracts have become an increasingly important source of revenue for small businesses. With such spending doubling over the last decade to more than $500 billion, doing business with the Federal Government is no longer simply a nice option to have but is, instead, a critical factor in small businesses' ability to succeed.

Thank you and I yield back.

Chairman HANNA. If additional members have an opening statement prepared, I ask that they submit it for the record.

I would like to explain quickly our timing system. Everybody has 5 minutes. We will be flexible. We are interested in what you have to say. And then when the yellow light goes on, you have got a minute. So that is how it works.

**STATEMENTS OF MARK MCCALLUM, CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS, WASHINGTON, D.C.; THOMAS J. KELLEHER, JR., SENIOR PARTNER, SMITH, CURRIE & HANCOCK, ATLANTA, GA, TESTIFYING ON BEHALF OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA; HELENE COMBS DREILING, FIRST VICE PRESIDENT, THE AMERICAN INSTITUTE OF ARCHITECTS, ROANOKE, VA, TESTIFYING ON BEHALF OF THE AMERICAN INSTITUTE OF ARCHITECTS; AND FELICIA JAMES, PRESIDENT, PRIMESTAR CONSTRUCTION, DALLAS, TEXAS, TESTIFYING ON BEHALF OF THE AMERICAN INSTITUTE OF ARCHITECTS**

Chairman HANNA. Our first witness today is Mr. Mark McCallum. Mr. McCallum is the chief executive officer of the National Association of Surety Bond Producers, NASBP, an international association of companies employing professional surety bond producers and brokers.

Thank you for being here. You may begin.

**STATEMENT OF MARK MCCALLUM**

Mr. MCCALLUM. Thank you Chairman Hanna, Ranking Member Meng. I am here today in support of H.R. 776, the Security and Bonding Act of 2013, a needed bill that will prevent the continued victimization of construction businesses, many of which often are small businesses, by unscrupulous and unregulated individuals, who promise surety guarantees without valid or sufficient assets backing those guarantees. Surety bonds are an essential component of the Federal procurement process. They are required by the Miller act on Federal construction contracts. Bonds preserve taxpayer funds by ensuring only that qualified companies seek award of publicly funded contracts and by providing a third-party guarantee of performance to contracting agencies and payment remedies to subcontractors and suppliers should the prime contractor fail to pay them or become insolvent. Without recourse to a valid payment bond, unpaid substance suppliers—especially small businesses—may not continue as viable businesses.

Performance and payment bonds are only as good as the financial soundness of the company or person issuing the bonds. A surety that is not sound financially cannot add to the credit standing of the firm to which it is bonded. It also is more likely to default on its obligation to supply the needed protection promised by the bond. For these reasons, well regulated and stable surety markets are imperative. But the words "well regulated" and "stable" only apply in the context of corporate sureties. They do not apply to the individual surety bond market.

Let me explain. Corporate sureties writing on Federal projects must possess a certificate of authority from the U.S. Treasury Department, which conducts a thorough financial review of the surety and sets a single bond size limit for that surety. Corporate sureties are licensed in the States in which they conduct surety business and must obtain certificates of authority from State insurance commissioners. They are regularly audited. They file financial reports with regulators. They file the rates they intend to charge for their bonds and are subject to market conduct investigations. Individual

sureties do not receive the same high level of scrutiny. Under applicable Federal regulations, they are vetted solely by contracting officers, who often are overburdened and under-resourced and are not trained to evaluate surety assets. Federal regulations do not require individual sureties to possess a certificate of authority as an insurer in any State. They are not required to furnish character information, such as information about criminal convictions, tax liens, bankruptcies, or cease and desist orders levied against them. If a contracting officer fails to perform the investigation of the individual surety adequately and the assets backing the individual surety bond prove insufficient or nonexistent, unpaid substance suppliers are denied their statutory payment remedy and contracting agencies are denied their guarantee of contract performance. The history of Federal procurement offers many examples of harmed small businesses which discover too late that no real assets back the individual surety bond furnished to the government. You can find such examples in my written testimony.

H.R. 776 offers a straightforward solution to this problem. It requires individual sureties to pledge solely those assets that are public debt obligations unconditionally guaranteed by the U.S. Government, such as U.S. Treasury bills and notes. These assets are given to the Federal contracting authority which deposits them in a Federal depository, ensuring that pledge assets are real, sufficient, convertible to cash and in the physical custody and control of the Federal Government.

Passage of H.R. 776 will close the door left open for unscrupulous individuals to place worthless bonds on Federal contracts. Contracting agencies and construction businesses of all sizes then will have confidence that the protections promised by individual surety bonds are, indeed, genuine and are backed with existent valuable assets. H.R. 776 also contains an additional benefit for small businesses. It will bolster the regulated surety markets available to small contractor participants in the U.S. SBA Surety Bond Guarantee Program, which provides guarantees to surety companies which extend surety credit to small, often emerging businesses which otherwise might not qualify for surety credit. These small firms then can pursue award of Federal contracts and do not have to resort to securing surety credit from unregulated and unsafe markets.

H.R. 776 increases the guarantee against losses given the surety companies from 70 percent to 90 percent as an inducement for them to participate in the program. I encourage every member of the subcommittee to support H.R. 776, and I would be pleased to answer any questions you may have of me. Thank you so much.

Chairman HANNA. Thank you.

Our next witness is Thomas Kelleher.

Mr. Kelleher is the senior partner for Smith, Currie & Hancock LLP in Atlanta, Georgia, where he specializes in Federal Government contracting and construction. He is testifying here today on behalf of the Associated General Contractors of America. Mr. Kelleher proudly served in the United States Army from 1968 to 1973, and we thank you for your service.

Sir, you may begin.

**STATEMENT OF THOMAS J. KELLEHER, JR.**

Mr. KELLEHER. Thank you. For 4 years, since I left the service, I have counseled contractors large and small on a wide variety of small business issues. From my experience, AGC members, a majority of whom have less than 20 employees, recognize the benefits that the various small business programs provide for the industry as a whole as well as for those firms that qualify to participate in the small business programs. However, the AGC believes that the current rules are structured in a manner that causes firms to perform in a way that meets the technical requirements but may not fulfill the spirit and intent underlying these small business programs. Consequently, we thank the committee for its consideration and urge it to continue efforts to allow awards to lower tier small business subcontractors to count against prime contractor goals for small business subcontracting; secondly, to prohibit the use of reverse bid auctions or reverse auctions in the procurement of the construction or construction-related services. We agree with Mr. McCallum's views on the bonding, and we fully support the notion that two-step design bill, which the AIA will address, should be the way that design bill procurement is obtained.

Now turning first to reverse auctions, we concur with the position of the Corps of Engineers, and we recommend consideration of the Corps' July 26, 2004, report on its pilot program with reverse auctions. Basically, the Corps found that it was not appropriate for construction-related services. I have got two personal observations.

If bidders fail to exercise discipline in the reverse auction and get caught up in the auction atmosphere, they are going to bid under cost. Under cost results in problems for the owner, the contractors, and the subcontractors. Lawyers may benefit because there are more claims and disputes, but the quality of the project will suffer. Consequently, we support legislation to prohibit the use of reverse auctions in construction.

Small business credits. The current small business program provides goals for general contractors who are large businesses to make the percentage of their awards as subcontracts to small business firms. However, they don't allow the large general contractors to count any awards to small businesses at the second, third, and so forth lower tiers. Consequently, the prime's focus is on the first tier only because that is what is getting counted. While there is a requirement to lower tier large business contractors have subcontracting plans, the members' experience is that the adherence to the letter of that is spotty. The reporting is spotty. Consequently, it is entirely possible that the government—your committee—don't have a full picture of what is being awarded to small businesses. We need transparency. And in my personal view, you need a single point of responsibility.

Looking at the slides—and you have copies of these in your folders—the first one is the transparency slide.

If the small business awards are made at the second and third tier, the general contractor, even though it has a plan, is not focused on second and third tiers. These may well get lost. Now under the current program, if we look at the next slide, we have a hypotheses of a $100 million project; 70 percent is going to be subcontracted. The agency has set a 40 percent goal, meaning $28

million. The general contractor makes an award to a small business for $28 million at the first tier because that is what is counted and then its focus ends. It moves on to other topics. It may or may not be awards below that first tier made by these large businesses. It may not be reported.

What we are proposing is that the general contractor be given the overall responsibility for the program. So the last chart, sir, is the same $100 million project. But the goal has been increased from 40 percent for small business subcontracting to 60 percent small business subcontracting.

A good question is, what is the general contractor going to do? In my view, they are going to still first emphasize small business subcontracting at the first tier because they control that more directly. And if they can count second and even third tier, we may well have more subcontracting achieved than otherwise would be achieved. And that is the purpose of our supporting legislation to allow counting at lower tiers.

The current electronic reporting system is capable of handling that. What we need is legislation to permit general contractors to award and count at lower tiers. In my view—I was managing partner in my law firm—when you have one person or one entity responsible, you get far better performance than when you split it up into a diverse group. Thank you.

Chairman HANNA. Thank you. Thank you very much.

Our third witness today is Ms. Helene Combs Dreiling.

Ms. Combs Dreiling is the principal at Plum Studio, which she founded in 2009. In addition to this, she currently serves as vice president and president-elect for the American Institute of Architects, who she is testifying on behalf of today. Thank you for being here. You may begin.

**STATEMENT OF HELENE COMBS DREILING**

Ms. Combs Dreiling. Chairman Hanna, Ranking Member Meng, and members of the committee, I am Helene Combs Dreiling, FAIA, executive director of the Virginia Center for Architecture and the 2013 first vice president of the American Institute of Architects. I want to thank you for the opportunity to testify today on behalf of the AIA and its more than 81,000 members.

The economic crisis has affected every American, and it hit the design and construction industry particularly hard. Architects are small business people: 95 percent of firms employ 50 or fewer individuals, and over 76 percent of firms make less than $1 million per year. The recovery seems to be fragile at best, as the construction industry lost 6,000 jobs just last month. The AIA's April architectural billings index shows a downward trend at 48.6 which is the lowest result since July 2012. This figure indicates a potential for reduced construction activity in the next 9 to 12 months.

Public sector work has been a lifeline for many small firms during this recession, but there is a significant financial burden to participate. When teams are short-listed an architecture firm spends roughly $260,000 to compete for a project. In almost 87 percent of Federal design build competitions, there are no stipends provided to the firm. Agencies would typically short list up to five teams for a design build project, but there have been recent reports where

some short list as many as eight to 10 teams. In these cases, the odds of being selected drop significantly.

Due to the current economic climate, small- and medium-sized firms face the Hobson's choice of betting it all on a contract they may not get or self-selecting out of the Federal design build market altogether. Unfortunately, Federal law enables agencies to create longer short lists. Under current law, agencies are required to short list between three and five teams. However, the law states that contracting officers have the flexibility to increase the number of finalists if doing so is in the government's interest. This exception is so broad that agencies use it without giving it a second thought. Therefore, we ask the committee to look at tightening the statute so that all firms can accurately determine the risks and rewards of participating in this market.

Another issue is when agencies use a one-step selection process. Agencies eliminate the preselection step and open the solicitation to all respondents. This allows the government to review as many responses as are submitted without reviewing the qualifications of the bidders prior to receiving a bid. This concept sounds attractive, but when a contracting officer receives multiple responses, this selection method becomes inefficient and costly to the Federal Government.

That is why we respectfully ask that the committee consider limiting the use of single step design build to projects that are less than $750,000. This threshold is based on U.S. Army Corps of Engineers' guidance issued in August of 2012. By limiting single step procurement to these projects, there will be less risk for teams who want to pursue this work, and it will allow for more small businesses to participate in the process.

In conclusion, I would like to thank Chairman Hanna, Ranking Member Meng, and members of the subcommittee for giving me this opportunity to testify before you today. The AIA commends you for your commitment to addressing the challenges that small businesses face in this economy and your leadership in advancing legislation that help small businesses drive the recovery. The challenges that we, as small business people, face are serious, but so is our commitment to play a leading role in rebuilding our country. Thank you.

Chairman HANNA. Thank you.

I now yield to Ranking Member Meng to introduce our final witness.

Ms. MENG. It is my pleasure to introduce Ms. Felicia James. Ms. James is the president of Primestar Construction located in Dallas, Texas. Primestar is a participant in several small business contracting programs, including the women-owned 8(a) and HUBZone programs. The construction firm specializes in tenant commercial improvements, parks, site improvements, and design build projects.

Ms. James is testifying on behalf of the U.S. Women's Chamber of Commerce, an organization that represents 500,000 members, three-quarters of whom are small business owners and Federal contractors.

Welcome Ms. James.

**STATEMENT OF FELICIA JAMES**

Ms. JAMES. Thank you.

Good day, Chairman Hanna and Ranking Member Meng and additional committee members. I am Felicia James, and I am the president of Primestar Construction Corporation.

Primestar is an 8(a) women-owned HUBZone full service construction firm having executed and successfully completed several trades identified in various construction projects. I am a member of the United States Women's Chamber of Commerce and was recently appointed as the agency liaison for the U.S. Navy and Air Force.

And we are a half a million member network of highly qualified, viable women-owned firms. I come to you today both having performed as a subcontractor and a general contractor with major specialty industries' self-performance capabilities. To elaborate on the two-step design build contracting vehicle, the reverse auction bidding, the ability to acquire critical tiers other than the first as it relates to subcontracting small businesses, Primestar Construction supports the use of two-step design build contracts.

Most design build public projects today are procured via a two-step approach. First, request for qualifications, RFQs, are sent to potential design build teams. Based on the responses to the RFQs, three to five design builders are short-listed and given request for proposals seeking competitive submittals, resulting in an award of a design build contract. Unfortunately, due in part to competition with large construction firms, many small businesses are not selected for inclusion among qualifying offerers at the second phase.

For small businesses to be successful in the two-step design build process, there needs to be a percent allocation reserve for small business groups like women-owned business and other small business set-asides within the second phase contract report. Primestar Construction is in strong opposition towards using reverse auction for construction projects. Reverse auction was originally designed to procure commodities and manufactured goods.

The procurement method should not be used for the following reasons: Reserve auctions do not necessarily guarantee lowest bid. Set-aside programs are nonexistent and could potentially violate Federal procurement laws, particularly the specified acquisition threshold, which helps small businesses currently. Small businesses are unable to compete with incumbents, typically large primes, who have multiple awards and can afford to reduce pricing.

Primestar Construction believes that prime contractors should not receive credit for small businesses used as second- and third-tier contractors. Prime contractors should be credited for first tier subcontractors only. Changing the credit process to include second and third tier contractors will encourage bundling projects into larger portions and diminish the amount of first tier subcontract awards to small businesses, thus making it harder to access larger portions of Federal projects and thereby making it difficult for small businesses to grow and become more competitive in the marketplace.

Including these tiers into the subcontracting plan would lower the number of first tier contracts awarded to small businesses that desperately need and are qualified to perform the work. The cur-

rent system allows for mentor protege relationships that will enhance my firm's capability to more successfully compete for larger projects. Changing the program will dilute the leverage of small business entities within the mentor protege program, and their participation and completion of larger construction projects would significantly be reduced.

Including second and third tier subcontractors in subcontracting plans would violate the intended purpose for the small business program, which is to maintain and strengthen the Nation's economy by enabling establishment and viable small businesses. Why? Because essentially one large prime would utilize a second large prime at the first tier, thereby creating the first tier void of any small business participation.

Primestar supports H.R. 776, the Security Bond Act of 2013. This bill adds transparency to the security assets. By increasing the guarantee to 90 percent, more small business and emerging businesses, like me, will have added opportunities to participate in the SBA's Surety Bond Guarantee Program. The provisions to increase SBA guarantee from $2 million to $6.5 million will help make bonds available to more small and minority contractors. Being able to clearly assess the backing of a bond will allow contractors and Federal contracting officers to know that the guarantee promises on paper are backed by honest companies pledging real assets.

Thank you for the opportunity to share my experience and provide my feedback on these key issues to the Small Business Committee.

Chairman HANNA. Thank you.

As you can see, we have a few minutes to get down to the floor and vote. And also there are 368 people who haven't. So we will be fine. But take a break. I am imagining 15, 20 minutes do you think? So we will be right back for questions. Thank you very much.

[Recess.]

Chairman HANNA. I call this committee back to order. And I will take the first question.

Mr. Kelleher, the law currently requires that a prime contractor's subcontracting goals reflect the maximum practicable utilization of small business on that contract. If we allow prime contractors to count lower tiers, would that mean more or less—and a lot of this was in your statement—opportunity for small businesses?

Mr. KELLEHER. Mr. Chairman, the law and the focus of the goals is set by the agencies in the procurements. For the general contractors, it is first tier. We fully expect that if lower tiers were counted, that those goals would increase and would also reflect awards to 8(a)s, service disabled firms, and so forth, as were reflected in the goals that were included in the 2013 NDAA for small business subcontracting.

So I think the opportunities would increase. And as I said earlier, I don't think the awards at the first tier will decrease simply because that is where the general contractor has the most control over the award process.

Chairman HANNA. Can I infer from what you are saying that you actually think the second tier group will have a faster track to become first tier contractors?

Mr. KELLEHER. I think they can. And I think the more that we can stimulate small businesses at every tier, we are going to help the industry. Construction is a small business-based industry.

Chairman HANNA. Can you see a reason to differentiate between small businesses and tiers in and of themselves?

Mr. KELLEHER. I think it is done simply because the industry thinks in terms of tiers. The Miller act is tier-oriented, as interpreted by the Supreme Court. And we tend to think in terms of tiers. The lawyers are somewhat to blame because we have the privity of contract concept ingrained in our head from the first day of law school. And consequently, we see privity and tiers somewhat parallel. But on a construction project, where you essentially have a team effort, the second and third tiers are certainly elevated enough that the general contractor knows who he has, who is out there and can work with them.

Chairman HANNA. Thank you very much.

Mr. McCallum, just from my own experience, what I think a lot of people understand about the bonding business is that, in a very real way, you are the regulators of who does or does not enter the competitive environment that requires a bond. There is not a government agency that does this. We rely on the surety bonds incentive not to lose money to get qualified people who are financially and experientially capable of completing what it is they start at the level of bidding they are doing. Therefore, it takes years sometimes to get a $1 million bond, a multimillion dollar bond and many, many assets. Is that fair?

Mr. MCCALLUM. Yes, Mr. Chairman. The central purpose behind surety bonding is to make sure that there is qualification, meaning a prequalification process that is undertaken by the surety to evaluate a construction firm to see if they will be qualified, in the surety's opinion, to pursue award of a particular contract. And they want companies to be successful and they want them to have measured growth so that they can assume those obligations and then gradually grow so that they are successful over the long term.

Chairman HANNA. So, to extrapolate then, to allow people into the market that do not have the financial capability or the experience—either one, but have to have both, in any way to pay a higher fee for a bonding order to get in, to have specious assets to get in or a bonding company to do the same, all of that kind of steps over the system that keeps people at a level that they are capable of competing at and completing. Is that fair?

Mr. MCCALLUM. Yes. You have to remember, surety bonds are insurance. However, they are very much different from a traditional insurance policy. So they are more in the nature of a credit arrangement. And the importance there is that they are written so that there is no expectation of loss, unlike a typical insurance policy that it is actuarially determined because it assumes a loss.

Chairman HANNA. So the zero loss ratio means that when you identify a company that you are willing to bond, you are virtually saying, we are 100 percent sure you can finish?

Mr. MCCALLUM. They are confident that that is a company qualified to undertake——

Chairman HANNA. Right. So you become that wall that protects the public by your not wanting to lose money or have a bond defaulted on.

Mr. MCCALLUM. Correct. So it is to protect the taxpayer dollars that are being invested in these public contracts in the first instance to make sure that these are qualified companies. And to the extent if there is a loss, if there is a default, in that event, they stand behind that, and they make sure that that contract will be completed. And also, very importantly, that the subs and suppliers, the lower tiers have a payment remedy. You have to remember on public work, there are no mechanics liens because it is public property. So the only remedy in the event of nonpayment by the sub and the supplier is recourse to a valid payment bond. And if that is not valid, then they are without that remedy and can go insolvent themselves, losing those jobs.

Chairman HANNA. Thank you.

I yield to Ranking Member Meng.

Ms. MENG. Thank you. I have a question for Mr. McCallum. We have heard of instances in which sureties have used inadequate or nonexistent assets to secure multimillion dollar project bonds. What repercussions does this type of fraud have on the Federal Government and on the contractors that rely on these bonds?

Mr. MCCALLUM. Thank you. It actually has very significant repercussions. So, again, if those assets aren't there, then the contracting agency, in the event that the prime contractor defaults, has no recourse. They are going to have to use additional taxpayer funds to complete that work, where otherwise they would be able to place that risk on the surety who stands there to provide that protection. But on an individual surety context if there are no assets, then that paper is worthless. So you have more taxpayer dollars being expended. And again, as I said earlier, the downstream parties will be without payment because they are likely not paid by the prime because they may have defaulted, become insolvent and then there is no payment. They have no direct recourse against the government. They are not in privity of contract so that payment bond is the only remedy they have and there is nothing there, then they are out of payment and may be out of business.

Ms. MENG. And you have also advocated for increasing the SBA guarantee to upwards of 90 percent. If this occurred, how many more small business bonds would your members issue?

Mr. MCCALLUM. My members are the bond producers, so they are the agents that work with the companies to get them in position to be bonded to qualify for bonding. We believe that increasing the guarantee would add greater participation by surety companies in the program. Currently, the program is divided into two programs. There is the prior approval and the preferred program. And we have seen I think approximately 17 companies now participate in the prior approval program. But the preferred program only has four companies, and it currently provides a 70 percent guarantee. And we think that it would be important to increase that guarantee—one, to attract those companies, and two, to make a larger business case for their success in participating in the program. So, in certain instances, they may actually be able to go to a reinsurer and get a better situation than the guarantee that would be offered

by the SBA. You increase the guarantee in the preferred program, and then now you have a better case—a business case for them to participate and write more bonds to small businesses that they otherwise wouldn't and increase the regulated market for those small businesses.

If I might add, one of the things that surety companies take great pride in as well as bond producers is maturing the businesses. So it is a relationship that they have. And they want to see those businesses succeed, and they provide all sorts of assistance, including referrals to professional service providers and others. They don't make money unless these businesses make money. And it is very important for them to have measured growth for success in the long term.

Ms. MENG. Do you think if there are more applicants for these bonds with an increase, that the SBA would be able to handle the workload?

Mr. MCCALLUM. One of the things that we have been very encouraged about in the last I would say 5 years or so is that the SBA has really made tremendous outreach to industry, working on a dialogue and how they can improve their processes. And it wasn't just listening. They have done things. So they have increased and streamlined their application. They have looked at making sure that the program responds in a design build context. A lot of different improvements that they have done. Plus there have been legislative enhancements to the program as well.

All that, they have maintained a very low loss ratio. I think any surety would be proud to have the loss ratio that SBA has experienced. So I think we have, with growing confidence, believed that that program could continue to achieve, to achieve the potential that you alluded to and would be able to handle the increased business with a higher guarantee.

Ms. MENG. Another question for Mr. Kelleher and Ms. James maybe.

The proposed legislation for bid listing at the Federal level is modeled after laws that currently exist in many States. However, despite the effectiveness of these provisions, some argue that there are privy of contract issues within these laws. Do you find this criticism to be accurate?

Mr. KELLEHER. I think the general criticism of bid listing at the Federal level needs to be looked at with one step removed from the privy issue. When I got out of the service, which was a long time ago, we were in the midst of a large GSA courthouse and Federal office building construction program all throughout the United States. The GSA instituted bid listing. It was a disaster, except for the lawyers, because you couldn't fill out the forms without creating an opportunity for an ambiguity and a bid protest. Ultimately, GSA dropped the program after—I am going to say 5 or 6 years. And I can get the information and provide it to the AGC as to what GSA said at the time. Privity issues I don't think are as important as the impracticality of doing it within the context of the Federal program if it is seal bids in a negotiated area.

What I am seeing the agencies doing, Corps of Engineers and the Naval Facility Engineering Command is asking contractors to—both large and small—to submit with their proposals on negotiated

contracts what they are calling small business participation plans. In those RFPs, the agencies are setting forth goals for awards to small business firms at all tiers—multiple tiers, not just first tier. And they are saying contractor understand. That is different from the subcontracting plan. The labels are close but they are different plans, different goals.

And then they tell the contractors, you will get greater evaluation credit when you review the proposal if you provide higher numbers at the various tiers, including every type of small business preference program that is there, and you will get a higher valuation if you give us evidence of a binding commitment to the firms that you designate. That allows the team to be put together, not in a shotgun marriage, and it incentivizes the contractors to stimulate small business contracting at every tier and involve every type of firm, women-owned, 8(a), service-disabled regular small business.

That is a good approach to addressing the problem. When you have mandatory listing, you have a problem that—do I list A or B? They have given me different prices, different scopes; I don't know if they are bondable or insurable the day. If it is done as part of a proposal where the team has worked together, then those issues take care of themselves. I think it can be done but listing in a seal bid, you are responsive or you are not responsive, is an invitation to go back to the late 1970s early 1980s, when every project that I was aware of in the southeast got protest. And then we rebid, and guess what happened the second time around? There would be a protest again because the underlying problem with the listing system was still there.

Ms. JAMES. I can concur with Mr. Kelleher in that at the various tiers, when we provide that information with proposals, speaking from a general contractor now, what I do in providing that information with my proposal is provide the LOIs, the letter of intents, to be able to show that I have secured that subcontractor and the subcontractors beneath me, I make it a requirement to be sure that they have a committed letter as well, and therefore, I am able to manage both tiers and provide additional services to other small businesses.

Ms. MENG. I have a question for Ms. Combs.

Each construction project offers its own unique set of factors that will help determine its cost. For example, a company constructing a building in my district in New York will not face the same conditions as a firm with a project in Florida. Do you believe that the reverse auction process allows the agencies to consider the variables that construction projects face?

Ms. Combs Dreiling. I am afraid I am not the reverse auction specialist, Ms. Meng. Mr. Kelleher would be the one to—I would be able to answer more questions in the design build realm, but that I think is probably better answered by him if that is okay.

Ms. MENG. Thank you.

Mr. KELLEHER. I am going to answer your question, Ms. Meng, with yes and then explain why I am saying yes without qualification. The reverse auction approach doesn't reflect the conditions in any locale. It is designed—and the first time I heard it explained, the agency representative said, we have had success buying lettuce.

And I thought lettuce is not a construction project. Design bid build or design build. There are so many variables whether you are in New York or Florida. The labor market, the team is going to be different. A contractor from New York could go down to Florida if it is licensed and bid on work, but the subcontractors would probably be different. The labor market is different the labor weather is different. The site conditions. So even if you take the same building and move it from here to there, it is not the same project. And reverse bid auctions assume that all the variables are fixed, like you are in a manufacturing plant turning out widgets, and that is why, in my opinion, it does not fit. It is the squarest peg in the roundest hole.

Ms. MENG. I yield back.

Chairman HANNA. Thank you.

Mr. Bentivolio.

Mr. BENTIVOLIO. Thank you, Mr. Chairman.

Thank you all for coming here today. I apologize. I had to leave to go vote, and I missed part of your introductions, but as a former vocational education teacher teaching computer design, I have an interest in the design build process. And I thought the industry like design build, what has changed?

Ms. Combs Dreiling. As you well know, any project delivery has challenges of its own, but I think what occurs with the particular use of design build with Federal Government projects here is that it requires architects, engineers, subcontractors, contractors to perform a great deal of work in order to even secure the project. Even with two step, what we are seeing is that our firms are—just architecture firms, and of course, this is multiplied when you consider the other members of the design construction industry who participated in the team, but just the architects are expending in the neighborhood of $260,000 of their own resources within their firms to sort of take the chance of getting a project. And if it is three firms, it is a one in three chance. If it is five teams, it is one in five. And with some of the one-steps, it is way up there in terms of how much they are risking to secure this work.

Additionally, most of our firms are small; 95 percent of firms in the AIA are fewer than 50 employees—this happened when all the buzzing was occurring so I will say it again because I want to make sure that you all caught this—and 76 percent of these firms have gross revenues of under $1 million a year. Well, to think of sort of spending a quarter of that just on the chance of getting one project is just something that a lot of folks are not willing to do just to get the keep the doors open, so I think it is cutting out a lot of potential firms that could participate and narrowing the auctions that the government has on who could perform this work in terms of the teams.

Mr. BENTIVOLIO. Okay. So let's see if I understand this right. What somebody's proposing— and I will have to go through my notes—but is that—well, how did it used to get done? Did the general contractor contract to the design firm and then make the proposal? How did that work before?

Ms. Combs Dreiling. Well, typically, in the historic past, the project methodology design bid would have been utilized where there was not a sort of teaming effort between and among a num-

ber of players in the design and construction industry. So the architect would have designed the project and then sent it out for a bid, and contractors would have bid on it. And then it would have proceeded to construction. So design build was adopted in order to hopefully save time and hopefully save money for the Federal Government, which is what we all want as taxpayers. But it has resulted in some cases in a very difficult situation for architecture firms, contracting firms, engineering firms, and small subcontractors, and I would mention small and large, to be quite truthful, in doing so much work on the chance of actually being awarded the project.

You are familiar with the construction process. So these firms are now—these teams are going through what would be in former design bid build terms well into design development because they have to know how much the project is going to cost. Well, in order to do that, you must have a notion of the heating, ventilating, and air conditioning systems, all the other building systems, the building components, the cost of those, and it requires a fairly detailed set of documents to get to that point to provide the actual bid.

Mr. BENTIVOLIO. Because the contractor has a better feel for what the costs are in actual construction where the firm traditionally doesn't because they are design.

Ms. Combs Dreiling. That is right.

Mr. BENTIVOLIO. Thank you. I appreciate it.

I yield back, Mr. Chairman. Thank you.

Chairman HANNA. I saw everyone's head nodding when you spoke. Anybody disagree with that? The $750,000 limit and the sort of two-tier system or two-process system, what you are really saying, to paraphrase, so correct me if I am misinterpreting, is that it will increase opportunity because it will add certainty to the process and reduce the potential cost. So it is really venture capital that you are putting out there that you may never see again so it encourages you to get involved.

Therefore, the limit, the 76 percent, under a million, all of that opens up the market to people—Ms. James and anyone else who falls under that headline, so in a very real way, it adds to competition. It adds certainty to the process, and it lowers your upside risk and gives you an opportunity to look at the process and say, do I want to go to the next step.

Ms. Combs Dreiling. That is exactly it.

Mr. MCCALLUM. That is right.

Mr. KELLEHER. And Mr. Chairman, it applies across the board to the general contractors and the specialty trade contractors. They are incurring substantial costs developing the bids. They work closely with the design team to come up with a concept that they think the agency would accept. So they are investing money too. So there is a deterrent here in a one-step design build proposal for smaller contractors to participate. They don't have the assets. And if the total cost of a proposal is $400,000 and you are doing $10 million a year, how much money do you have to invest?

Chairman HANNA. So what you are really saying, the way we keep it actually limits competition and un-invites or rather invites large companies who have venture capital and really severely pro-

hibits smaller people from getting involved because they can't begin to compete at that bigger level. Is that fair?

Mr. KELLEHER. Yes, sir.

Mr. MCCALLUM. That is fair.

Chairman HANNA. Thank you.

Just quickly, reverse bidding. Let me give you an interpretation of what I am getting at. If I were to say it encourages people to go to the least common denominator; it encourages people, in the frenzy of bidding, that people make mistakes on things that are subjective, pencils and lettuce, probably not that subjective. People know their exact costs; they know how close they can get to the bottom line. They know everything they need to know. So the reverse bidding construction projects as opposed to things does not make sense, that—and that is—does anybody disagree with that? Would anyone like to say anything about that?

Mr. KELLEHER. May I add one comment, Mr. Chairman? In that reverse bid auction, the contractor sees the lowest prevailing price on a computer screen. It can opt to see the lower price or walk away. What he can't do in that tightened bidding environment is sit down, think about its cost, coordinate with its contractors, who have a large piece of this action. So it is putting the number in. And maybe it works, and maybe it doesn't work. But when it doesn't work, I can assure you, Mr. Chairman, the disputes and the problems between the contractors, the sureties and the agencies are going to incur, and the only people who benefit are the lawyers.

Chairman HANNA. So you are saying we encourage, by doing this in construction, people to do irrational things and reactive things.

Mr. KELLEHER. Dumb. Dumb things.

Chairman HANNA. And dumb things.

Ms. Combs Dreiling. Yes, sir.

Chairman HANNA. Thank you very much.

I will close this panel. Thank you for your time today. And quickly, is there anything you want us to ask the next panel?

If not, you are dismissed. Thank you for your time and service.

Ms. Combs Dreiling. Thank you so much.

Chairman HANNA. The second panel, you can proceed if you like.

**STATEMENTS OF JAMES C. DALTON, CHIEF OF THE ENGINEERING AND CONSTRUCTION DIVISION, DIRECTORATE OF CIVIL WORKS, UNITED STATES ARMY CORP OF ENGINEERS, WASHINGTON, D.C.; AND JEANNE HULIT, ASSOCIATE ADMINISTRATOR FOR CAPITAL ACCESS, UNITED STATES SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.**

Chairman HANNA. Thank you. I would like to welcome our next panel.

Our next witness today is Mr. James Dalton. Mr. Dalton serves as chief engineering and construction directorate at the United States Army Corps of Engineers. In his role, he is responsible for the execution of over $10 billion of design and construction programs for the Army, Air Force, Department of Defense, and other Federal agencies and over 60 foreign nations. You may begin, sir.

**STATEMENT OF JAMES C. DALTON**

Mr. DALTON. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, as you just said, my name is James Dalton. I am the chief of engineering and construction for the Corps of Engineers. I guide the development of engineering and construction policy for the Corps' worldwide civil works and military missions programs. I certainly thank you for the opportunity to testify here today for this important issue.

The Corps fully recognizes the value small businesses bring to our national economy, and each year, we typically award over 40 percent of the prime contract dollars to small business. My testimony will address the Corps' policy regarding two-step design build contracts use of reverse auctions for construction, the Corps' experience with accepting surety bonds provided by noncorporate sureties and whether allowing prime contractors to receive credit for lower tiered subcontractors will improve the use of small business.

The Corps employs various acquisition strategies and contract types to perform its mission. The Corps uses the design build project delivery system for many construction requirements and prefers the use of a two-step or two-phase selection procedure. This allows offerers to submit experience and past performance information in step one, and then only the qualified offerers advance to phase two or step two of the competition. These offerers did have a much more favorable chance of winning, as the previous panel just discussed, and that also provides an incentive for them to submit superior proposals.

With regard to reverse auctions, the Corps has limited experience in the use of reverse auctions. The Corps conducted a pilot study and found no basis to determine that reverse auctions provide significant savings over traditional acquisition methods for construction. Reverse auctions provide benefit when the acquisition is of a controlled and consistent nature with little or no variability. Construction is not a commodity, has variability, and it is more similar to a professional service.

With regard to the Miller Act, it requires construction contracts to furnish a performance and payment bond for contracts greater than $150,000. The Corps considers the acceptability of noncorporate sureties when offered by a contractor. While we do not collect data requiring—regarding the use of noncorporate sureties generally, they are proposed much less frequently than the corporate sureties are. The use of noncorporate sureties requires an expenditure of government resources from the contracting officer and his or her team to investigate the susceptibility of pledge assets. Failure to establish the pledged assets claim value or the asset's ownership generally causes rejection of the surety. It is unknown if allowing large primes—large prime contractors to claim credit for small businesses used by their second and third tier subcontractors would lead to improved usage of small business firms on Corps contracts.

Subcontracting dollars are currently being reported regardless of their tier level. A contract with a subcontracting plan requires a prime to flow down the requirement to its subcontractors and for subcontractors to do the same to their subcontractors. Allowing prime contractors to receive credit, however, for subcontracting activity at all tiers would require a change in the method of account-

ing for subcontracting activities across the entire Federal Government.

Mr. Chairman, thank you for inviting the Corps to appear before this subcommittee to address challenges faced by small businesses, and I look forward to answering any questions from you or members.

Chairman HANNA. Thank you.

Thank you, Mr. Dalton.

Our next witness is Jeanne Hulit. Ms. Hulit is the associate administrator for the Office of Capital Access at the Small Business Administration.

Prior to her Federal Government service Ms. Hulit was the senior vice president for commercial lending at citizens bank. She also worked for key bank as a middle market lender.

Welcome. You may begin.

**STATEMENT OF JEANNE HULIT**

Ms. HULIT. Thank you. Thank you Chairman Hanna, Ranking Member Meng, and members of the committee. I am pleased to testify before you today on the topic of surety bonds.

The Small Business Administration Surety Bond Guarantee Program was established in 1971 to help small businesses obtain the surety bonds that are often required as a condition for awarding a construction contract or subcontract. For example, the Federal Government requires a surety bond on any construction contract valued $150,000 or more. Most State and local organizations have similar bonding requirements, as do private construction projects.

SBA's program helps small and emerging firms become bonded by guaranteeing a portion of the bond issued by a participating surety company. The SBA guarantee acts as an incentive for surety companies to bond eligible small businesses that might not otherwise fit traditional surety bonding criteria.

There are two types of SBA surety bond guarantees. First, those made through our Prior Approval Program, which provide an 80 or 90 percent guarantee, depending on the size of the contract or the type of the small business; and second, those made under SBA's preferred program which provides a 70 percent guarantee. There are 20 surety companies participating in the SBA program, 17 in the Prior Approval Program, and four in the Preferred Program. Currently, about 86 percent of our bonds are issued through the Prior Approval Program, while 14 percent are made through the Preferred Program.

I am pleased to report that in fiscal year 2013, it is on track to be the seventh consecutive year in program growth. To date, we have issued 7,595 bond guarantees, representing contracts valued at approximately $3.5 billion. This is approximately 49 percent ahead of last year's volume in terms of the number of bonds issued and about 75 percent ahead of last year's number in terms of the total contract value. The SBA values its partnership with the surety industry and knows that it is fundamental to the program's success.

We continue to refine our processes and procedures to strengthen this partnership. We are currently completing work on our regulatory changes that address several industry concerns while simpli-

fying and clarifying processes for our surety partners. In August, we implemented a new Quick App guarantee application, known as Quick App, for contracts valued at $250,000 or less. The streamlined process adopts an industry best practice by eliminating much of the paperwork on smaller contracts without increasing performance risk. So far this year, Quick App accounts for approximately 19 percent of eligible applications. And since implementation, over 685 quick bond guarantees have been issued. Based on our experience over the past 8 months as well as feedback from our surety partners, we are further refining the Quick App process and expect its use to increase substantially during fiscal year 2014.

In terms of legislative changes within our program, the National Defense Authorization Act of 2013 raised the individual contract ceiling in the program from $2 million to $6.5 million. The new law also permits bonding of Federal contracts up to $10 million where the contracting officer certifies an SBA surety bond guarantee is in the best interest of the government. Additionally, the Defense Authorization Act provides SBA with broader discretion when it assesses bond liability.

These changes have been well received across the surety industry and among small businesses. So far, we have issued 97 bond guarantees on contracts valued at $2 million or more. This represents approximately $290 million in new construction contracts. In addition, we have seen the number of participating surety agents increase by 15 percent and have admitted two new surety companies to the program in just the past few months. With respect to the key program performance measures, the average contract default rate over the past 5 years is approximately 3 percent. It is noteworthy that we have not seen any defaults on the larger contracts authorized under the Defense Authorization Act, and we have had zero defaults on the quick app contracts. Additionally, the program has experienced a positive cash flow in each of the past 6 years.

The SBA Surety Bond Guarantee Program is helping the small business community grow and prosper during the critical time in our Nation's economic recovery. We look forward to working closely with you and your staff on any changes to the program as well as other SBA initiatives that support small and emerging firms. I appreciate the opportunity to testify before you today. And I welcome any questions that you may have.

Chairman HANNA. Thank you.

So we are thinking of going, in H.R. 776, from 70 to 90. You said you had a positive cash flow. Can you interpret for me what that marginal increase would do? And do you think it would be a problem? And do you think you can absorb it if there is a problem, a proportionate problem?

Ms. HULIT. Sure. We are looking very closely at the program. We have seen a decline in the preferred sureties going down from 50 percent to 14 percent of our program, which is a very small number. We would like to see more participation in that program. Because of the additional cash flow we have, we do not expect it to increase our costs. And we have some history in our other programs that demonstrate that having the same guarantee level is not a disincentive.

Chairman HANNA. So, to sum, you believe that you could absorb it, that there would be additional cash flow. Because certainly you write bigger bonds, perhaps more bonds.

Ms. HULIT. Correct. In our historic track record, the default rate under the Preferred Program and the Prior Approval Program is not materially different. So I think that with appropriate analysis and resources that address oversight of any Preferred Program, we think that it is worth considering.

Chairman HANNA. Thank you.

Mr. Dalton, you mentioned that you currently keep track of all tiers of subcontractors. And then you went on to say that it would require—but you actually score somehow by the first tier. Is that fair?

Mr. DALTON. Yes, Mr. Chairman. What we require from our contractors is—the previous panel talked about the small business participation and sort of that tiering process of keeping up with first tier, second tier, all the way down to the last sub. We actually require that of our contractors. What we report out, though, for the agency's small business goals are just the first tier.

Chairman HANNA. Sure. I guess what I am driving at is that it wouldn't be an enormous burden to—since you already have the information—to count it differently.

Mr. DALTON. We have the electronic small business system software that we would actually have to make changes to. I am not exactly sure what and how involved that would be. But that is what it would require is changes to that system, which is really an accounting system that keeps up with the numbers, percentages of small business per contract. We could right now tell you if you pointed to a specific contract, we can look in that ESRS and identify what the amount of small business participation is.

Chairman HANNA. So you already know, it would just be a different way of adding the total.

Mr. DALTON. That is correct.

Chairman HANNA. Thank you very much.

You have mentioned you have had limited experience with reverse auctions. I am assuming that means you have had some. And maybe feel free to talk about that.

Mr. DALTON. Okay. We had a pilot program in which we looked at—I think it was, if I have got the numbers correct, five construction contracts and then a couple of—I will say—service type or commodity type contracts. And we looked at that as part of a pilot done during the—I think it was the fiscal year, maybe, 2008 program—I am not sure of the year. But we did a pilot program. And the purpose of that pilot was to actually look and determine if there were advantages in using reverse auction. Most notably is, was it a better way to get a better price for the government? Was it a better system in which we would actually secure contracts? The conclusion of that study, the pilot study, was that we did not find any substantial or even moderate advantage of using reverse auction. One of the problems with using reverse auction for construction—that is what I am referring to—is that because it is not a commodity, because it does have variability, it is difficult to measure one project or one solicitation against another. And so we could not conclude that there was a substantial savings in using reverse

auction over, for instance, seal bidding. I would agree with some of the comments made by the previous panel that when you are in a reverse auction environment, there is a tendency for—you know, you are trying to get to a lower bid so you don't have time to go back and check with subcontractors. So you could, in fact, have bids that need to later go back and you need to validate and sort of renegotiate.

The other thing we found with reverse auctions is that—and I am going to compare it to seal bidding because in seal bidding, what we are looking at is price as the determining factor. And so the same thing is the objective of reverse auctioning. But the reverse auctioning comes with a lot more administrative requirements and burden because of what has to be done by the contracting officer and that whole contracting community over and above just seal bidding.

Chairman HANNA. So what evidence you have is negative, and it is anecdotal in some ways but——

Mr. DALTON. Chairman, it was inconsistent. We could not conclude to you in that study that—here is an advantage in using reverse auction.

Chairman HANNA. Were you able to conclude the reverse, that it wasn't an advantage, or it is not the same thing?

Mr. DALTON. We do not think it is a good option for construction. We still maintain it as part of our—I will say toolkit. But we use it if we need commodities to go out and buy—if I was trying to buy bulk sand and stockpile bulk sand, then I could of course do it. But I would not recommend that for construction of facilities.

Chairman HANNA. Thank you very much.

Mr. Bentivolio.

Mr. BENTIVOLIO. Thank you very much, Mr. Chairman.

I probably need additional time because I have a lot of questions. I especially have an interest in how this might benefit some of the contractors in my district, of course.

So walk me through this. I remember, years ago, if I wanted a government contractor, I would go to the Commerce Business Daily and look up what bids were out there, and I would, you know, petition or submit documents. I forget what it was, 30 years ago. What about now? I have to get a bond or a surety bond, correct? And then I have to go through a bidding process. Could you kind of walk me through that? And mainly, if one of my constituents asked me, what is the process? To be perfectly honest, I would be kind of like—well, I don't know exactly. So what would be the first thing I would do? What are the steps, if you would, on how a contractor could bid on a government project in construction and the process—what you look for in a contractor getting a surety bond so they would qualify to get one, right? You have to go through an approval process, I am assuming, right? Could you explain that between the both of you?

Mr. DALTON. Well, I will try to start that if you don't mind. And I may miss some of these steps. But generally speaking, what happens is, instead of Commerce Business Daily right now, where you would go is you would look on the FedBizOpps, which is a Web site where we post all solicitations for Federal projects.

Mr. BENTIVOLIO. BizOpps.

Mr. DALTON. FedBizOpps.
Mr. BENTIVOLIO. I am sorry.
Mr. DALTON. Federal business opportunities.
Mr. BENTIVOLIO. Great.
Mr. DALTON. And you would look at that. And that would include a multitude of different types of contracts. The design builds that we were talking about earlier or simply construction contracts, service contracts, whatever type contract is out there that you are interested in. And you simply—at that time, you would contact—for instance, our district offices if you needed to talk with them or identify the fact that you are interested in proposing on a particular project. And you would receive a set of the bid documents so that you could take a look at those, do your own estimate, determine if it is something that you really would be interested in bidding on. Now the only bonding required if you actually solicit or submit a proposal is, you would have to propose—I think it is a bid bond because what we are after there is the government needs assurance that people are not just submitting proposals with no intent to follow through with actually making good on those proposals. So that bid bond is different than the surety bonds that we are talking about once you secure a contract. And so once you decide you actually are interested in bidding on or proposing on a particular contract, you submit your proposal. Depending on if it is best value, meaning a negotiated procurement, or if it is a seal bid. If it is a seal bid, you submit your proposal and wait for the results. If it is negotiated procurement, meaning best value, something other than price is as important as price, then you would actually find out if you were within that competitor zone. And we would actually negotiate, take a look, evaluate your proposal against the conditions in the contract, determine if you are the best value for the government. After which, at that time, if you are the—I will say the selected firm, then you would have to provide a payment and performance bond or a surety bond because what that does is it says to the government that, one, the performance part of it says that you will perform; and if you don't perform, then the government has a place to go to actually get another contract or someone will ensure the performance is done. And the payment bonding is to assure that you are paying the subcontractors. If you don't pay your suppliers or subcontractors, then that bond is called into active.
Mr. BENTIVOLIO. Thank you.
Ms. Hulit, how would I go about getting a surety bond? And what are the requirements?
Mr. DALTON. Well, the SBA provides a surety bond guarantee. We don't provide the bond. So you would have to get a surety from a surety company, the bond from the surety company. The surety company would come to us to get the bond guarantee when, for reasons for their own underwriting purposes, they wouldn't do it without the additional support of the government guarantee. That could be because it is in a particular industry or because it is a relatively new business, startup. They may not have had experience with a contract of that size for whatever reason. So we would look at the underwriting criteria provided by the surety company, do our own

assessment, and look at the reasons that they are asking for the government support.

Mr. BENTIVOLIO. Thank you very much.

I yield back.

Chairman HANNA. Thank you.

So, Mr. Dalton, just to sum up, the critical nature of this bonding, you have made it very clear how important it is—both of you—to the process.

So, in terms of what Mr. Mark McCallum said generally, you agree that to maintain the integrity of the bonding process, it is critical to the functioning of what both of you do?

Ms. HULIT. Clearly, because of the Miller Act, the government does require surety bonds for contracts over $150,000. We would like to see more small businesses be able to compete for government contracts, and the SBA Surety Bond Program works very closely in partnership.

Chairman HANNA. So, to that end, to have capable, competent, solvent institutions issuing these bonds is absolutely critical to your ability to do your jobs and provide certainty all across the spectrum of what you do.

Mr. DALTON. Yes, it is. In fact, there is a risk, and it is most of our district officers, our contracting officers, as was mentioned by the previous panel, have the burden of actually trying to determine if a noncorporate surety actually has the assets, the appropriate assets. If we are able to do the work and investigation that we should do up front, then that surety is rejected. We have got, I am sure, as others do, examples of where we may have had not fully investigated. So, therefore, we are in a bond when you find out that if you get to that point, that that surety——

Chairman HANNA. If we can find what those assets are, where they are coming, how they are secured, then your job is easier.

Mr. DALTON. Yes, sir.

Chairman HANNA. Thank you very much. I want to thank all our witnesses today. I appreciate your insights regarding the proposed legislative solutions. As we move forward, your insights, I am sure, will be invaluable.

I ask unanimous consent that all members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

This hearing is now adjourned. Thank you again.

[Whereupon, at 11:55 a.m., the subcommittee was adjourned.]

# APPENDIX

NATIONAL ASSOCATION OF SURETY BOND PRODUCERS

Written Testimony of Mark H. McCallum
Chief Executive Officer

Before the U.S. House of Representatives
Committee on Small Business
Subcommittee on Contracting and Workforce

In Support of

H.R. 776
The Security in Bonding Act of 2013


May 23, 2013

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The National Association of Surety Bond Producers (NASBP) is a national trade organization of professional surety bond producers, whose membership includes firms employing licensed surety bond producers placing bid, performance, and payment bonds throughout the United States and its territories. NASBP wishes to extend its appreciation to Chairman Hanna, Ranking Member Meng, and to the members of the Subcommittee on Contracting and Workforce of the U.S. House of Representatives' Committee on Small Business for the opportunity to provide written and oral testimony in strong support of H.R. 776, the "Security in Bonding Act of 2013."

By way of background, our testimony will begin with a brief description of the important role surety bonds play in the federal procurement arena.

## The Importance of Surety Bonds: Sound Public Policy

Corporate surety bonds are three-party contract agreements by which one party (a surety company) guarantees or promises a second party (the obligee/federal government) the successful performance of an obligation by a third party (the principal/contractor). In deciding to grant surety credit, the surety underwriter conducts in-depth analysis, also known as prequalification, of the capital, capacity and character of the construction firm during the underwriting process to determine the contractor's ability to fulfill contractual commitments. Surety bonds are an essential means to discern qualified construction companies and to guarantee contracts and payments, ensuring that vital public projects are completed, subcontracting entities are paid, and jobs are preserved.

The federal government has relied on surety bonds for prequalification of construction contractors and for performance and payment assurances since the late nineteenth century. In 1894, the U.S. Congress passed the Heard Act which codified the requirement for surety on U.S. government contracts and institutionalized the business of surety. In 1935, the Heard Act was superseded by the Miller Act, which required the continuation of these vital assurances so that U.S. taxpayer funds were protected and subcontractors and suppliers would receive payment for their labor and materials. Today, the Miller Act and applicable regulations require that, before any contract exceeding $150,000 is awarded for a federal construction contract, the prime contractor must furnish a performance bond and a payment bond to the contracting agency.

### Types of Surety Bonds

The bid bond assures that the bid has been submitted in good faith and the contractor will enter into the contract at the bid price and provide the required performance and payment bonds. A performance bond protects the project owner from financial loss should the contractor fail to perform the contract in accordance with its terms and conditions. The payment bond protects subcontractors and suppliers, which do not have direct contractual agreements with the public owner and which would be unable to recover lost wages or expenses should the contractor be unable to pay its financial obligations. Often, small construction businesses must access the federal procurement marketplace at

subcontractor and supplier levels, and the payment bond is their primary recourse and protection in the event of prime contractor nonpayment or insolvency.

**Role of the Bond Producer**

The bond producer plays a vital role in the federal construction process. The bond producer stands as the "bridge" between the construction firm and the surety company. The bond producer works closely with the construction business as an advisor, educator, and matchmaker to position the business to meet underwriting requirements in order to obtain surety credit.

The objective of the producer is not only to assist the contractor with obtaining surety credit for each contract requiring surety credit but to ensure that the contractor's business remains viable and thrives for years to come. To that end, bond producers assist construction firms of all sizes with creating networks of knowledgeable professional service providers, such as construction attorneys, certified public accountants familiar with construction business practices, and construction lenders, and may assist construction firms with market intelligence and even strategic and succession planning.

**H.R. 776 Supporters**

NASBP, along with the Associated Builders and Contractors, Inc. (ABC), the Associated General Contractors of America (AGC), the American Subcontractors Association (ASA), the Mechanical Contractors Association of America (MCAA), the Mid America Government Industry Coalition, Inc. (MAGIC), the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), the Construction Financial Management Association (CFMA), the Surety & Fidelity Association of America (SFAA) and the American Insurance Association (AIA) view H.R. 776 as a critical means to protect taxpayers, federal contracting entities, and construction businesses of all sizes by assuring the integrity of surety bonds on federal contracts when issued by individuals using a pledge of assets.

Engineering News Record (ENR), a prominent construction industry trade magazine published by McGraw-Hill Construction, with a circulation exceeding 250,000 subscribers, recently endorsed H.R. 776 after examining the practices and assets of individual sureties in a recent special report titled, "A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid."[1] ENR stated in its editorial that an overhaul of individual surety asset rules is now needed. An important public benefit of the bill, according to ENR, will be the clear view it provides of the individual surety's assets.[2] Moreover, "being able to see clearly the asset backing the bond will allow contractors and federal contracting officers to know the guarantees promised on paper are backed by honest companies pledging real assets."[3]

[1] Korman, Richard. "A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid". *Engineering News Record (ENR)*. February 21, 2013.
[2] "Clarity Needed on Individual Surety Assets". Editorial. *ENR*. March 4, 2013.
[3] Ibid.

**H.R. 776 Enhances Protection of Federal Contracting Agencies, Taxpayer Funds, and Construction Firms Furnishing Labor & Materials on Federal Projects**

As noted earlier, the Federal Miller Act requires contractors to furnish surety bonds on federal construction projects to ensure that prospective contractors are qualified to undertake federal construction contracts and that bonded contracts will be completed in the event of a contractor default, thereby protecting precious U.S. taxpayer dollars and subcontractors and suppliers, many of which are small businesses. The financial strength and stability of the surety is the key to the success of the surety bonding system.

Presently, there are three methods construction firms may use to furnish security on a federal construction project:

1. By securing a bond written by a corporate surety, that is vetted, approved, and audited by the U.S. Department of Treasury and listed in its Circular 570;
2. By using their own assets to post an "eligible obligation," i.e. a U.S.-backed security, in lieu of a surety bond. The security is pledged directly and deposited with the federal government until the contract is complete; or
3. By securing a bond from an unlicensed individual, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property owned in fee simple.

It is this third alternative that has proven consistently problematic to the financial detriment of contracting authorities and of subcontractors and suppliers performing on federal projects. NASBP, along with the other organizations supporting H.R. 776, believe that the current regulations pertaining to use of individual sureties on federal construction projects are fundamentally flawed, allowing gamesmanship by unlicensed persons acting as sureties. Such existing requirements need to be superseded by the statutory approach delineated in H.R. 776.

Federal Acquisition Regulation (FAR) 28.203-2(b)(3) permits federal contracting officers to accept bonds from natural persons, not companies, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property. These individuals neither are subject to the same scrutiny and vetting given to corporate sureties nor are they required to provide physical custody of the asset to the government that they pledge to secure their bonds to the contracting authority.

This lack of thorough scrutiny of individual sureties and control over their pledged assets has resulted in a number of documented situations where assets pledged by individual sureties have proven to be illusory or insufficient, causing significant financial harm to the federal government, to taxpayers, and to subcontractors and suppliers, many of whom are small businesses wholly reliant on the protections of payment bonds to safeguard their businesses.

Federal requirements do mandate a level of documentation and information from individual sureties. Individual sureties are required to complete, sign, and have notarized an affidavit of individual surety (SF 28), which is a standardized form for the purpose of eliciting a description of the assets pledged and the contracts on which they are pledged. SF 28, however, does not elicit other pertinent information, such as that about the character or fitness of the individual acting as surety, like criminal convictions, state insurance commissioner cease and desist orders, outstanding tax liens, or personal bankruptcies.

Under FAR requirements, the pledged assets also are supposed to be placed in an escrow arrangement by the individual surety, subject to the approval of the contracting officer. The individual surety, however, is not required to turn the assets over to the physical custody of the contracting authority. Each contracting officer, not the Department of Treasury, shoulders the entire burden of determining the acceptability of the individual surety, its documentation, the escrow or security arrangement, and the value and adequacy of pledged assets, and must do so in relatively short order to progress the contract procurement. A missed, incorrect, or forsaken step may mean the acceptance of a fraudulent or insufficient bond, rendering its apparent and much needed protection worthless.

This burden of assessing individual sureties is added to the already considerable responsibilities of contracting officers. They are required to determine the authenticity of the documentation of the assets pledged to support the individual surety's bond obligations and to verify that the pledged assets actually exist, are sufficient, and are available to the federal government. They have to know that a particular financial document is what it purports to be and to understand and to assess the different types of collateral, such as stocks and real estate located anywhere in the United States.

It is not clear if and how often federal contracting officers receive specific training to understand and to perform the needed tasks of examination concerning individual sureties. Documents of federal agencies suggest that there are occasions when federal contracting officers may not have a complete understanding of what is required of them to safeguard taxpayers and small businesses from individual surety fraud. The Financial Management Service of the U.S. Department of Treasury issued a "Special Informational Notice to All Bond-Approving (Contracting) Officers"[4] on February 3, 2006, still posted on the web site for the Financial Management Service at http://www.fms.treas.gov/c570/special_notice.pdf. This informational notice was directed to federal contracting officers to remind them of the applicable FAR requirements governing individual sureties. Specifically, the notice, a copy of which is attached to this testimony, states in part:

> *"Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice*

[4] United States Treasury Department, Financial Management Service, "Special Informational Notice to All Bond-Approving (Contracting) Officers", February 3, 2006.

*on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.*

*Recently, FMS has been made aware of instances where individual sureties are listing corporate debenture notes and other questionable assets on their 'Affidavit of Individual Surety', Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit."*

Likewise, the U.S. Department of the Interior issued a notice to its contracting officers in 2009 to remind them of FAR requirements associated with acceptance of individual surety bonds. This notice, titled "Department of the Interior Acquisition Policy Release (DIAPR) 2009-15," states that the Department of the Interior Office of Inspector General conducted an investigation of contracting personnel practices concerning individual sureties and found concerns.[5] Specifically, the release, a copy of which is attached to this testimony, states in part:

*"The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System."*

If a contracting officer fails to perform adequately the necessary investigation of an individual surety, and the individual surety pledges assets that do not exist, are insufficient, or are not readily convertible into cash to pay the obligations of the defaulted general contractor, everyone on the project from the contracting agency on down is left unprotected and at risk for financial loss. If the assets pledged to support the bonds are uncollectible, unpaid subcontractors and suppliers protected by the bond, many of which typically are small businesses, will suffer financial hardship and could, in turn, default and become insolvent.

**Examples of Improper Individual Surety Activity**

Little statistical data on individual surety problems is available, because individual sureties typically operate outside of state insurance regulatory structures, despite the fact that they are required under almost all state insurance codes to obtain certificates of authority to act as a surety insurer from state insurance commissioners. Moreover, the federal government does not require individual sureties writing bonds on federal contracts to furnish proof of licensure or authority to operate in a state jurisdiction as an surety insurer. Nonetheless, in recent years, illustrations of individual surety problems abound. These situations usually involve individual surety bond assets that turned out to

[5] United States. Department of the Interior. "Department of the Interior Acquisition Policy Release (DIAPR) 2009-15". September 8, 2009.

be inadequate, illusory, or unacceptable. One illustration is *United States ex rel. JBlanco Enterprises Inc. v. ABBA Bonding, Inc,* where, in spite of a March 11, 2005 cease and desist order from the Alabama Insurance Department, Mr. Morris Sears, doing business as ABBA Bonding, was able to submit bonds on a federal contract in Colorado supported by an affidavit (Standard Form 28) stating that ABBA Bonding had assets with a net worth of over $126 million. Although no assets were placed in escrow for the benefit of the government, the U.S. General Services Administration accepted the bonds anyway. JBlanco Enterprises, a small business 8a subcontractor performing work on federal contracts, nearly was forced to declare bankruptcy as a result of a deficient individual surety bond placed by Mr. Sears on a federal project that later proved to have no assets to support the bond. Ms. Jeanette Wellers, a principal of JBlanco Enterprises, provided oral and written testimony[6] about this situation during a hearing on H.R. 3534, a predecessor bill to H.R. 776, on March 5, 2012 before the U.S. House Committee on the Judiciary Subcommittee on Courts, Commercial and Administrative Law.

Sears eventually sought bankruptcy protection against numerous creditors (100+) arising from defaulted bond obligations, including protection against bond debts owed to three federal contracting agencies. Chief Bankruptcy Judge Margaret A. Mahoney, U.S. Bankruptcy Court, Southern District of Alabama held that Sears had "knowingly made misrepresentations regarding collateral he pledged in support of surety bonds."[7] Judge Mahoney also found that Sears falsely stated that the real estate had not been pledged to any other bond contract within three years prior to the execution of any Affidavit and that Sears made misrepresentations to numerous agencies. Thus, the Bankruptcy Court determined that that Sears' debts to the government were nondischargeable. His false statements then formed the basis of a criminal indictment against Sears, who currently is undergoing criminal prosecution in the U.S. District Court for the South District of Alabama.

Another notable example surfaced in March 2010, when George Douglas Black, Sr., an individual surety doing business as Infinity Surety, was arrested and charged by the U.S. Department of Justice with mail fraud for allegedly selling more than $100 million of worthless construction bonds to 150 different construction companies on local, state, and federal public works projects, while receiving $2.8 million in fees.[8] Among Black's alleged victims were the U.S. Department of Navy, the Beaumont Independent School District of Texas, and the Monroe Airport in Monroe, Louisiana.[9] It is alleged that Black repeatedly pledged the same small piece of real property to insure multi-million dollar state and federal construction contracts. Mr. Black currently awaits criminal sentencing in June by the U.S. District Court for the Southern District of Texas, Houston Division.

Mr. Robert Joe Hanson, aka Robert Joe Lyon, aka Dennis Joe Lyon, aka "Chief Joe Blue Eyes" has acted as an individual surety and as an unauthorized surety company on private and public contracts, including federal contracts, under such names as Global Bonding,

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[6] Wellers, Jeanette. Written Testimony before U.S. House Committee on the Judiciary Subcommittee on Courts, Commercial and Administrative Law. March 5, 2012.
[7] United States. Department of Justice. US Attorney's Office. Southern District of Alabama. "Pensacola Man Indicted in Government Contract Surety Bond Fraud Scheme". June 28, 2012.
[8] United States. Department of Justice. US Attorney's Office. Southern District of Texas. "Fort Worth Man Indicted for Mail Fraud Arising From Alleged Nationwide Scheme to Sell Over $100 Million in Fraudulent Securities". April 12, 2010.
[9] Mowbray, Rebecca. "Houston Officials charge George Douglas Black Sr. with mail fraud, alleging he peddled bogus bonds". *The Times-Picayune (Nola.com)*. March 30, 2010.

Millennium Bonding Enterprises, Shonto Surety, Southwest Surety, or Navajo All Risk, Inc. and Native American Funds Management Services. Lyon/Hanson has a long history of issuing fraudulent bonds that continues to the present. From 2004 to 2010 the Montana Commissioner of Securities and Insurance fined Dennis Lyon $645,561[10] for supplying bid and performance bonds without a license and without verifiable assets to support these bonds. In October 2012, Lyon was fined an additional $155,000 by the Montana Commissioner, which includes $148,000 in restitution for Fort Belknap Tribal Construction on the Fort Belknap Indian Reservation for Lyon's unlicensed individual surety company, Native American Funds Management Services[11]. A number of state insurance commissioners have issued cease and desist orders against Hanson including those in California, Connecticut, Florida, Georgia, Montana, Nevada, Ohio, Texas and Washington. These orders, however, have not deterred Lyon/Hanson from continuing to issue worthless bonds by changing aliases and jurisdictions.

The above individuals operated nationally and across state boundaries, victimizing public and private entities, small construction businesses, and businesses of all sizes. These examples, unfortunately, are not isolated instances. Other examples exist, both past and present, showing where individual surety bond assets proved illusory, uncollectible, or deficient. More businesses, many of whom are likely to be small businesses, will be victimized unless Congress acts to correct these flawed requirements, which permit unscrupulous individuals, many with criminal, personal insolvency, and tax lien histories, to issue worthless surety bonds on taxpayer-funded federal construction contracts.

**Common-Sense Legislative Solution**

H.R. 776, the "Security in Bonding Act of 2013," is a simple, common-sense legislative solution that will eliminate opportunities for fraud by mandating that real assets be placed in the care and custody of the contracting authority. The bill requires individual sureties to pledge solely those assets defined as eligible obligations by the Secretary of the Treasury. An eligible obligation is a public debt obligation of the U.S. Government and an obligation whose principal and interest is unconditionally guaranteed by the U.S. Government, such as U.S. Treasury bills, notes, and bonds, certain HUD government guaranteed notes and certificates, and certain Ginnie Mae securities, among other federally guaranteed securities. These safe and stable assets then are provided to the federal contracting authority, which will deposit them in a federal depository designated by the Secretary of the Treasury, ensuring that pledged assets are real, sufficient, convertible, and in the physical custody and control of the federal government. This is nothing more than what now is statutorily required of contractors who wish to pledge collateral as security on a federal contract in lieu of a surety bond.

If enacted, H.R. 776 will eliminate the gamesmanship and opportunities for fraud endemic in the current regulatory system governing individual surety bonds and pledged assets and will remove a considerable administrative burden from federal contracting officers. Federal contracting officers no longer will need to assess a range of pledged

[10] Richey, Erin. "Montana Adds to Fines Against Alleged Surety Con Artist". *ENR*. December 4, 2012.
[11] Ibid.

assets, as all pledged assets will be limited to assets unconditionally guaranteed by the federal government; they simply will need to gain custody over the asset to deposit the asset in a federal depository, such as the Federal Reserve Bank, St. Louis. The asset will be released upon successful performance of the bonded obligation, with any accrued interest inuring to the benefit of the individual surety pledging the government-backed asset.

Construction businesses working on a construction project—either as subcontractors, suppliers, or workers on the job—have no control over the prime contractor's choice of security provided to the federal government, but they suffer the most harm financially if the provided security proves illusory. The impact is particularly acute on small construction businesses, which may not have the strength to weather a significant disruption to their cash flow. Passage of H.R. 776 will mean that contracting agencies and the numerous subcontractors and suppliers on federal construction projects, in the event of a performance or payment default will know that adequate and reliable security is in place to guarantee that they will be paid for their valid claims.

**Enhance the SBA Surety Bond Guarantee Program: Increase the Guarantee to 90% for Surety Companies**

The SBA Surety Bond Guarantee Program (Program) was created decades ago to ensure that small and emerging contractors have the opportunity to bid on public construction work, grow their businesses and remain a viable part of the U.S. economy. The Program was created with the goal of providing surety bonds to small and emerging contractors that may not otherwise qualify for bonds in the standard surety market. Under the direction of Frank Lalumiere, the Program's Director, the Program has undertaken important efforts to improve its functioning, for example, by streamlining its application processes, implementing a "fast track" application for bonds under $250,000, quickly responding to claims, and expanding the Program's reach to include design-build contracts. This year, significant enhancements were made to the Program to assist small and emerging contractors by increasing the contract size amount guaranteed by the SBA from $2 million to $6.5 million. These changes are expected provide greater access to private and public contracts and secure larger contracts vital to small business growth.

These recent SBA efforts have improved surety company participation, but NASBP believes that greater surety company participation could be realized by offering a higher guarantee percentage, such as a guarantee of 90 percent, which is contemplated in Section 3 of H.R. 776. Increasing the guarantee would permit more sureties to make the internal business case for underwriting emerging businesses through the Program. The increase in guarantees likely will stimulate greater corporate surety participation, providing more regulated surety markets to small businesses which otherwise do not qualify for surety credit in the standard market. These small businesses, which typically have very little working capital, are often the ones that are tempted by unscrupulous individual sureties that seek vulnerable businesses, offering surety credit to anyone, regardless of the firm's qualifications, financial wherewithal, or experience, and at rates many times higher than corporate surety markets.

Conclusion

NASBP appreciates the opportunity to provide the Subcommittee with information about the compelling need to enact H.R. 776: (1) to protect taxpayer funds and construction businesses performing as subcontractors and suppliers on federal construction contracts and (2) to raise awareness about important issues and enhancements made to the SBA Surety Bond Guarantees Program. NASBP hopes its testimony proves beneficial and welcomes any inquiries from the Subcommittee on the points raised in this written testimony or on other matters pertinent to small businesses and surety bonding.

# A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid | ENR: Engineering News Record | McGraw-Hill Construction

http://enr.construction.com/business_management/ethics_corruption/2013/0225-a-bold-individual-surety-claims-his-coal-backed-bonds-are-rock-solid.asp

February 21, 2013

Richard Korman

Slide Show

photo by lundy bailey

Coal Controversy Scarborough has pledged coal waste at this West Virginia tract as the asset backing his bonds.



**Special Investigative Report** Individual surety has had plenty of shady dealings. One of the regulars in the field, Robert Joe Hanson, has received cease-and-desist orders for insurance-related violations in at least 10 states in as many years. His latest scrape with the law came last year in Montana, where state regulators accused him of selling bogus surety bonds to Native American contractors under a new alias, Chief Joe Blue Eyes. Created by federal regulations for small contractors as an alternative to more risk-averse corporate sureties, individual sureties are people willing to provide payment and performance bonds—guarantees made in exchange for a premium based on a small percentage of the contract—to small firms that would otherwise fail to qualify for public-works projects.

Corporate sureties and brokers view these individuals with disdain, calling their practices a taint on the industry and citing examples such as Hanson, who has pledged assets of questionable value that may not exist at all. The corporate sureties want to tighten the rules on assets via legislation in a way that would knock most individual sureties out of business—including an antagonist who claims he is providing a service for an underserved market that corporate sureties avoid.

Unlike individual sureties who have stayed in the shadows, Edmund C. Scarborough is the founder and chairman of the U.S. Individual Surety Association. The website of Scarborough's Charlottesville, Va.-based company, IBCS Fidelity, boasts of being capable of providing bonds as high as $50 million, "far surpassing most other sureties," as the website says.

"If you or your clients have been told NO by traditional sureties, try one of our many services," the website proclaims.

A burly former Florida contractor who claims to have written 6,000 to 7,000 bonds for small federal, state and local contractors, Scarborough says he has developed a business with revenue from bond premiums of $5 million to $6 million a year. He says he backs his bonds with about 15 million tons of Kentucky and West Virginia usable coal waste. He also says the bonds are as solid as those provided by A.M. Best-rated insurance companies, such as Travelers and Liberty Mutual.


Scarborough has a gift for hitting the corporate surety world, deploying a narrative in which he plays a noble, unbending David struggling valiantly against corporate surety's imposing Goliath—all for the benefit of small and minority contractors.

"We've had hundreds of bonds accepted by the federal government—and hundreds also rejected—and the only common denominator among the rejected bonds is that they were all minority contractors," he says. If Congress adopts the proposed asset rule changes, eliminating coal products and requiring a federal Treasury bond or something similar, corporate sureties would have "won their battle at the expense of the overwhelming majority of small, up-and-coming or independent contractors, who would no longer exist."

In Scarborough's view, the surety playing field tilts steeply to the corporate side. Everything works against the individual surety providers and their clients. For one thing, corporate sureties can leverage the assets backing their bonds, while an individual surety must back them on a dollar-for-dollar basis. Furthermore, in Scarborough's case, corporate sureties nitpick over whether coal is more like a speculative asset (such as antiques) forbidden under federal rules or more like a share of an actively traded stock, which is allowed.

For accounting purposes, corporate surety is covered by detailed rules for risk-based capital; any bond requires a certain amount of risk-based capital behind it. Even accounting rules for sureties are rigged, he claims. "The surety world is the only entity that [generally accepted accounting

principles] say you don't have to report the liability on your books because it's a third-party guarantee," says Scarborough. "And they call me a crook."

Scarborough's adversaries may agree with that quote but keep quiet because they fear what they call his litigious streak. Scarborough has kept several lawyers skilled in the art of litigation quite busy.

Does Scarborough deserve a place in a small-business Hall of Fame or in a rogues' gallery with figures such as Robert Joe Hanson? The answer may depend on the value of Scarborough's hard-to-verify coal holdings and his opponents' will to outlast him in court battles.

For eight years, Scarborough has engaged the U.S. government and the corporate surety industry in the judicial equivalent of trench warfare. In 2005, he sued the U.S. Army and the National Association of Surety Bond Producers (NASBP) over their disclosure of information about an Army investigation of individual sureties and possible fraud. Although he and NASBP settled long ago, on Jan. 15 Scarborough filed an amended complaint in his claim against the U.S. Army. The complaint alleges the Army violated the federal Privacy Act in divulging details of Scarborough's business publicly.

A separate matter carried the bond battle from federal court to Capitol Hill. In 2011, surety bond brokers, insurers and major contracting associations threw their support behind H.R. 3534, the Security in Bonding Act, which passed the House of Representatives last year but died in the Senate. It would have tightened asset rules, requiring U.S. Treasury bonds or related debt securities to be placed in escrow and held by the obligee. Rep. Richard Hanna (R-N.Y.) reintroduced the measure this year on Feb. 15. It included an expansion of the Small Business Administration's surety loan guarantees.

### Data Lacking at Federal Agencies

In an effort to gauge the impact of individual sureties, ENR sent Freedom of Information Act requests to eight federal agencies to determine how many are in use on federal projects. Most had no data about how often individual surety bonds have been accepted.

Scarborough has never been charged or convicted of a surety-related criminal offense. But state regulators have ordered him not to do business in Iowa and Virginia, and he has been embroiled in numerous lawsuits. Civil court and state regulatory records provide a glimpse into the controversies that have flared over Scarborough's business dealings. As part of its investigation, ENR reviewed thousands of pages of court pleadings, evidence and cease-and-desist orders and interviewed a number of Scarborough's business associates, clients and adversaries.

Under payment and performance surety guarantees, the surety promises to finish work or make payments on behalf of the contractor if the contractor defaults. Scarborough presents a real alternative to corporate sureties that stick to rigorous underwriting designed to avert losses. "I respect the man," says Wayne Frazier, president of the Maryland-Washington Minority Contractors Association. "He is a maverick and tough to deal with, and most successful business people are that way."

# A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid | ENR: Engineering News Record | McGraw-Hill Construction

http://enr.construction.com/business_management/ethics_corruption/2013/0225-A-Bold-Individual-Surety-Claims-His-Coal-Backed-Bonds-are-Rock-Solid.asp?page=2

February 21, 2013

Richard Korman


**BONDS**

What is less clear is the way Scarborough appears to have evaded the risks typically undertaken by a surety, such as transferring the risk to owners and contractors via contract terms or artful phrases in bond agreements.

For example, Scarborough's bond agreements previously stated that the premium or fee was "fully earned" on execution of his bond agreement. However, in several instances in which the project was canceled or the bond rejected, he refused to give back the six-figure premiums. He says he has since changed his policy, and now will give the money back or provide a credit. When faced with a claim, Scarborough also appears at times to rely on contractual terms in the small print of the bond agreements. That and the now-changed fee policy has led to litigation (see box).

Steven Golia, president of Scarborough's IBCS Fidelity, says lawsuits aren't necessarily a sign that anything is wrong. "When wrongly accused and taken advantage of, we stand up. We fight the good fight."

Another way Scarborough reduces his risk, his critics claim, has been by apparently inflating the value of the assets backing some of his bonds. To fully understand the issue, one needs to review the bond-related documents, visit coal country, the hills and impoundment ponds of places such as Nicholas County, W.Va., and learn a bit more about Scarborough.

**Early Career and Starting an Individual Surety**

A 1980 graduate of Hillsborough High School in Tampa, Fla., Scarborough started as a rod man on a survey crew, loading equipment and laying out stakes, according to his 2007 sworn deposition testimony given in his lawsuit against NASBP. Scarborough says he was trying to start his own business in Tampa in the mid-1980s when, while only 20 years old, he inadvertently wrote numerous worthless checks, most of which were for small amounts. He eventually served part of a one-year jail sentence for fraud.

The total amount owed was $330,000. "I paid everybody every penny," Scarborough said in the

NASBP deposition. In 2008, former Florida Gov. Charlie Crist issued Scarborough a pardon, helping to wipe a grand theft conviction from his record.

Scarborough returned to construction and worked for a New Jersey-based contractor, Megan Group, reaching the position of executive vice president, according to Scarborough's deposition. Late in 2003, he says he left Megan Group, but by this time he was also operating his own company, Scarborough Civil Corp.

A disaster struck in July 2000, when an unsupported trench caved in and killed two Scarborough Civil employees. Federal safety officials proposed a penalty against the firm. While Scarborough says he was devastated by the loss of the two employees, the families of the two workers sought additional restitution beyond what was covered by insurance. Scarborough sold his company, and the year after the accident he and his wife and business partner, Yvonne, filed for Chapter 13 bankruptcy protection in federal court.

A turn of fortune was not far off. Scarborough set himself up in a new individual surety business in late 2003. In April 2004, he signed a memorandum of understanding under which bonds he wrote would be backed with collateral or reinsured by Larry J. Wright, whom a Baltimore jury had convicted of surety fraud in 1992. As it turned out, Wright also backed bonds for Hanson, who sold them to Montana contractors, according to orders filed by the Montana state auditor in 2007 banning Hanson from insurance activity. For those Montana bonds, Wright's company, Underwriters Reinsurance, stated that it had a balance sheet rich with cash and equivalents worth half a billion dollars and another half billion in gold and precious metals, according to the Montana state auditor.

Scarborough said in the 2007 NASBP deposition that he didn't have reasons to question the asset pledged by Wright and relied on Underwriters Reinsurance's balance sheet.

The same year that Scarborough started as an individual surety, Special Agent Christopher Hamblen of the Army's Criminal Investigation Division began looking into fraudulent surety bonds on federal projects. The investigation centered on Hanson but also encompassed Scarborough, Wright and George Gowen, who provided trust receipts that appeared to back Scarborough's bond assets. Hanson could not be reached for comment.

Hamblen created and issued a so-called criminal alert notice, a government document whose aim was to advise [Dept. of Defense] officials of possible fraudulent activity and collect information for the investigation. NASBP, in the April-May 2005 issue of its newsletter, the Pipeline, reproduced the text of the criminal alert notice. The results were far-reaching and costly, fouling up potentially profitable bond placements with important construction contractors, Scarborough said in the deposition.

Scarborough, Wright and Gowen retaliated by suing the Army and the association. The three plaintiffs alleged that the criminal alert notice contained "personal and confidential information about them" and implicated them in "the alleged fraudulent and criminal activities of Hanson." Much of the information was inaccurate and misleading, the plaintiffs argued, and "in no way relates to their current businesses or Scarborough's issuance of bonds."

Despite the blow from the criminal alert notice, Scarborough's surety business had gross receipts of $5.8 million in 2006, from which Scarborough and his wife paid themselves $448,000 in salary, according to discussions of his tax returns in the deposition. Around this time, Scarborough also was looking to expand his influence, hiring Washington, D.C., lobbyist Gilbert Genn and, with others, pushing for new laws to open the doors to individual surety in Florida, New York and other states. A 2006 law in Maryland partly opened that state's public works to individual surety guarantees for public projects.

"I wrote it," Scarborough in the deposition said of the Maryland law.

About this time, Scarborough revamped his bond program, parting ways with Wright and Hanson ("I wasn't crazy about them," Scarborough says). To back his bonds, he started to acquire coal properties, including ones in West Virginia and Kentucky. He also continued to expand his reach and clientele, promising to provide up to $50 million in surety credit.

Issue: 03/04/2013

# Clarity Needed on Individual Surety Assets

03/04/2013

*by the editors of ENR*



Related Links:
ENR's Individual Surety Special Report
Editorial: Why Bond Assets Need Scrutiny



ENR's recent special report on individual surety suggests that an overhaul of individual-surety asset rules is needed now more than ever. The Security in Bonding Act, which passed the House last year but died in the Senate, has been resubmitted to the House by Rep. Richard Hanna (R -N.Y.), and Congress soon will have another chance to make certain that surety guarantees pledged on federal projects are backed by legitimate, easy-to-verify assets.

The U.S. has seen enough mystifying complexity in securities in recent years to learn that, in financial matters, transparency is a necessity, not just a virtue.

One part of Rep. Hanna's proposed legislation would increase the federal government's guarantee under the Small Business Administration's surety-bond guarantee program. Recent revisions to the SBA program have tripled the eligible amount, to $6.5 million from $2 million, that SBA will guarantee. Any additional flexibility should help make bonds available to more small and minority contractors.

The bill would require any individual surety to pledge very specific assets, such as a Treasury bill or a similar instrument, and place them under the control of a government entity. This pathway would eliminate some of the alleged fraud that has occurred and take the guesswork out of the asset verification process for federal contracting officers.

**Reasonable Certainty About Claims**

Another important public benefit of the proposed bill concerns the clear view it provides of the individual surety's asset. When the asset is easier to verify, project members who hold payment and performance bonds can reasonably expect that claims will be met.

This area is where last year's House subcommittee hearing on the bill provides important lessons. Past individual-surety frauds have used schemes involving re-insurance, mine securities and precious metals.

The extent of the possible deception can be seen in the June 2008 balance-sheet statement of Underwriters Reinsurance Co. The balance sheet listed assets of $1 billion, with half the value in "cash equivalents (Gold and Precious Metals)." To demonstrate the rock-solid legitimacy of the pledged assets, Underwriters Reinsurance used a "re-insurance debenture," chosen apparently for its formidable-sounding name, to confirm that the assets on the balance sheet will be available to benefit the project's owner and contractors. This is where contractors and contracting officers must be careful: Financial instruments such as debentures and trust receipts don't necessarily guarantee that the asset's value has been verified. Busy small contractors have little time to sort through it all.

Being able to see clearly the asset backing a bond will allow contractors and federal contracting officers to know the guarantees promised on paper are backed by honest companies pledging real assets.

Keywords: Surety; Individuals; Hanna

Telephone (202) 874-6850

February 3, 2006

SPECIAL INFORMATIONAL NOTICE TO ALL BOND-APPROVING (CONTRACTING) OFFICERS

Important Information Regarding the Use of Individual Sureties on Federal Bonds

Subchapter E, Part 28 of the Federal Acquisition Regulation (FAR) provides guidance as to the acceptability of sureties and other security for Federal bonds. Acceptable security on Federal bonds include, but are not limited to, both corporate and individual sureties. FAR § 28.201. Acceptable corporate sureties must appear on the Department of Treasury's Circular 570. Treasury's Financial Management Service, Surety Bond Branch (FMS), publishes Department Circular 570 in the Federal Register.

Contracting officers determine the acceptability of individual sureties and ensure that the individual surety's pledged assets are sufficient to cover the bond obligation in accordance with the guidance outlined in the FAR § 28.203.

Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where **individual sureties are listing corporate debenture notes and other questionable assets on their "Affidavit of Individual Surety"**, Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit. **FAR § 28.203(b) specifically requires the use of the Standard Form 28.** In addition, FAR § 28.203-2(a) states that **"the Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations."**

FAR § 28.203-2(b) includes **examples of acceptable assets**, such as:

- cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution
- United State Government securities
- stocks and bonds actively traded on a national U.S. security exchange
- real property owned fee simple by the surety subject to certain conditions (refer to FAR 28.203-2(b)(4))
- irrevocable letters of credit issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number.

Furthermore, FAR § 28.203-2(c) lists **unacceptable assets**, but indicates that the list is not all-inclusive. The following are listed as unacceptable assets:

- notes or account receivable
- foreign securities

- real property located outside the United States, its territories or possessions
- real property used as the principal residence of the surety
- real property owned concurrently
- life estates, leasehold estates, or future interest in real property
- personal property except as listed in FAR 28.203-2(b)
- stocks and bonds of the individual surety in a controlled, affiliated or closely held concern of the offeror/contractor
- corporate assets
- speculative assets
- letters of credit except as provided in FAR 28.203(b)(5)

The FAR also requires that the Government be given a security interest in any acceptable assets pledged by an individual surety. FAR § 28.203-1(a).

Prior to acceptance of an individual surety, FAR guidelines require contracting officers to obtain the opinion of their legal counsel as to the adequacy of the documentation pledging assets. FAR § 28.203(f).

If you have any questions, please feel free to contact this office at the above number.

Sincerely,

**/Signed/ Rose Miller**

Rose Miller
Manager
Surety Bond Branch

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

SEP 0 8 2009

TAKE PRIDE IN AMERICA

**Department of the Interior Acquisition Policy Release (DIAPR) 2009-15**

**Subject:** Individual Surety Bonds

**References:** Department of the Interior (DOI) Office of Inspector General (OIG) June 29, 2007, memorandum, *Management Advisory of Investigative Results: Individual Surety Bonds*, OIG Case Number OI-NM-06-0174-I; and
Federal Acquisition Regulation (FAR) Part 28, *Bonds and Insurance*

1. **Purpose:**

The purpose of this DIAPR is to remind contracting personnel of key FAR requirements associated with accepting an individual surety bond for a contract to protect the Federal Government from financial losses.

2. **Effective Date:** Effective upon signature.

3. **Expiration Date:**

This DIAPR will remain in effect until superseded or cancelled.

4. **Background and Explanation:**

The OIG investigated allegations of misuse of individual surety bonds for construction contracts. The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about the individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System.

The Miller Act, 40 U.S.C. 3131, requires performance and payment bonds for any construction contract exceeding $100,000, with some limited exceptions. Agencies must obtain adequate security for bonds with contracts for supplies or services, including construction. Acceptable forms of security include corporate or individual surety bonds, as well as others described in FAR Part 28.204.

The majority of surety bonds for government contracts are supplied by corporate sureties. Corporate sureties are companies approved by the Treasury Department to provide surety bonds. However, the FAR permits a contractor to secure bonds from "individual sureties" if approved by the CO.

FAR Part 28.203, *Acceptability of Individual Sureties*, outlines procedures COs must follow to determine the acceptability of an individual surety.

5. **Action Required:**

To reduce the risk of financial loss to the Department from contracts backed with individual surety payment and performance bonds, DOI COs must:

- Familiarize themselves with FAR requirements for individual surety bonds.
- Identify and verify assets, backing individual surety payment and performance bonds, prior to accepting them.
- Confirm and ensure that the government has control over pledged assets through the duration of the contract.
- Vet matters involving the acceptance of individual surety bonds with the Office of the Solicitor.
- Verify whether individual sureties are suspended or debarred.

6. **Additional Information:**

Please disseminate this guidance within your bureau. It will also be available on the web at http://www.doi.gov/pam/diapr.html. Questions may be directed to Brigitte Meffert, Senior Procurement Analyst, Office of Acquisition and Property Management, at (202) 208-3348, or via e-mail at Brigitte_Meffert@ios.doi.gov.

Debra E. Sonderman
Director, Office of Acquisition and Property Management
and Senior Procurement Executive

# JBlanco Enterprises, Inc.

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The Honorable Howard Coble
Chairman, Subcommittee on Court, Commercial and Administrative Law
Committee on the Judiciary
517 Cannon H.O.B.
Washington, D.C. 20515

The Honorable Steve Cohen
Ranking Member, Subcommittee on Court, Commercial and Administrative Law
Committee on the Judiciary
517 Cannon H.O.B.
Washington, D.C. 20515

Dear Chairman and Ranking Member,

I am contacting you about recently introduced legislation, H.R. 3534, titled the "Security in Bonding Act of 2011," which has been referred to the House Judiciary Subcommittee on Courts, Commercial and Administrative Law, of which you are a member. I strongly support passage of this important bill, because it will bolster the integrity of the federal bonding process by making certain that the assets pledged under non-corporate surety bonds are sufficient and in the care of knowledgeable authorities, thereby protecting small businesses and the funds of taxpayers.

I am a Colorado resident and the owner of a small construction business, JBlanco Enterprises, which furnishes labor and materials on federal construction projects. I nearly lost my business as a result of a deficient individual surety bond placed on a federal project that later proved to have no assets behind it. In the spring of 2006, JBlanco Enterprises entered into a contract with a certified 8(a) prime contractor to roof a U.S. Customs House in Denver, Colorado. Because this was a federal project, JBlanco Enterprises felt it could rely on the contracting agency and the federal contracting officer to ensure that a properly executed payment bond was in place to protect subcontractors and suppliers in the event that the prime contractor failed to meet its contractual payment obligations. Sadly, however, this was not the case.

During the course of the project, the prime contractor became in arrears in paying JBlanco Enterprises for its services. As a result, JBlanco Enterprises placed a claim against the payment bond and requested that the federal contracting officer provide the name of the surety company. We did not receive a response from the contracting officer, and the prime contractor promptly terminated our roofing contract. When we filed suit against the prime contractor, the contract officer, upon learning of the lawsuit, then provided the name of the surety to us.

In the course of litigation, our attorney learned the true nature of the payment bond. The prime contractor had secured a bond from a non-corporate individual surety, not from a certified corporate surety approved and listed on Treasury Circular 570. Moreover, the assets pledged to back the payment bond apparently did not exist. We later learned that this non-corporate individual surety had proffered other bonds on multiple federal and non-federal construction projects. Apart from expensive and time-consuming litigation with the prime contractor, the payment bond was our only recourse for payment—we have no lien rights against federal real property. The inability to recover our payment bond claim was a severe financial hardship for JBlanco Enterprises, endangering our business viability.

Passage of H.R. 3534 will ensure that other small businesses relying on payment bonds on federal projects will not have to experience what JBlanco Enterprises experienced; rather, they can have

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confidence that adequate and reliable security is in place to guarantee that they will be paid for their labor and materials in the event a prime contactor will not be able to fulfill its financial obligations.

Under current law, construction contractors have three options for securing their obligations under their contracts with the federal government. They can obtain a surety bond from a surety company, which is vetted and approved by the U.S. Department of Treasury. In lieu of a bond, contractors can pledge and deposit assets with the federal government until the contract is complete. In such situations, only assets backed by the federal government can be pledged. The third option permits individuals to serve as sureties for contractors by pledging their assets to back the bonds. These individuals are called "individual sureties." Only individual sureties are permitted to pledge assets not backed by the federal government. In fact, individual sureties are allowed to pledge stocks, bonds, and real property, and are not required to deposit such assets with the federal government for the duration of the contract.

To the extent that individual sureties pledge assets that do not exist, are difficult to verify, or are not readily convertible into cash to pay the obligations of the contractor in case of default, subcontractors and suppliers are left unprotected. Experience has shown that if the assets pledged are uncollectible, subcontractors, suppliers, and workers on the job are left with no payment remedy if they are not paid. The federal government is left with unfunded expenses to complete the construction projects. Yet, under federal law and regulations, a contractor pledging assets directly to the federal government to guarantee a contract obligation is subject to far more stringent rules than an individual, acting as a surety for profit, who pledges his or her own assets to guarantee a contract obligation.

H.R. 3534 is just good common sense. The security that stands behind every federal contractor's obligations to the federal government should be governed by the same rules. There should be either a corporate surety bond in place from a company approved by the U.S. Treasury or assets with readily identifiable value pledged and relinquished to the federal government while the construction project is ongoing. The same rules that apply to the security that a federal contractor pledges as collateral should also apply to the security proffered by an individual acting as a surety for a contractor.

I urge you to support H.R. 3534. Please do not let another small business owner fall victim to that of a individual surety bond backed with illusory or worthless assets.

Sincerely,

Jeanette Wellers
JBlanco Enterprises Inc.

# Department of Justice

United States Attorney Kenyen R. Brown
Southern District of Alabama

FOR IMMEDIATE RELEASE
DATE: JUNE 28, 2012
WWW.USDOJ.GOV/USAO/ALS

CONTACT: THOMAS LOFTIS
PH: (251) 441-5845 FX: (251) 441-5277

## PENSACOLA MAN INDICTED IN GOVERNMENT CONTRACT SURETY BOND FRAUD SCHEME

MOBILE, AL – United States Attorney Kenyen Brown announces that Morris Sears of Pensacola, Florida was indicted by the Federal Grand Jury in a six count indictment charging Sears with falsifying documents to obstruct the proper administration of Government contracts by the National Park Service and the General Services Administration.

The charges concern bogus "Individual Surety" bonds to guarantee performance of Government contracts and payments to sub-contractors. Sears caused Government contracting officers to accept the bonds by making false statements in sworn Individual Surety Affidavits about the collateral he had to stand behind the bonds. He also repeatedly stated that he had not previously pledged named collateral for other bonds, when he pledged the same collateral to different agencies time after time. Sears operated his bonding business in Lilian, Baldwin County, Alabama.

Sears's activities came to light in his bankruptcy case. In the bankruptcy case, the National Park Service claimed over a million dollars in losses from Sears's misconduct. Chief Bankruptcy Judge Mahoney held that Sears "knowingly made misrepresentations regarding collateral he pledged in support of surety bonds" and that [Sears] falsely stated that he owned the pledged property free and clear of liens or mortgages. She found that Sears also falsely stated that the real estate had not been pledged to any other bond contract within three years prior to the execution of any Affidavit and that Sears made misrepresentations numerous times to numerous agencies.... The Debtor's misrepresentations regarding the pledged collateral were made in sworn affidavits submitted to government agencies". United States v. Sears, Order of May 22, 2012.

The statutory maximum penalty for the alleged violations is twenty years imprisonment, plus a fine of not more than $250,000. As in all criminal cases, an Indictment returned by a grand jury is only a charge and the Defendant is presumed innocent.

The case was investigated by agents of the Office of Inspector General, General Services Administration, the Defense Criminal Investigation Service, the Office of Inspector General, United States Department of the Interior, the Office of Inspector General, United States Department of Veterans Affairs, and the Office of Inspector General, United States Department of Agriculture. United States Attorney Kenyen R. Brown stated that the prosecution shows that the Department of Justice will pursuer those who defraud the taxpayers by cheating on Government contracts.

Brian D. Miller, Inspector General of the General Services Administration, stated: "There is a kind of an honor system in the federal procurement process. We rely on contractors to tell us the truth in contracting. When they do not, it is important to hold them accountable. Those who deliberately lie and falsify documents should be punished."

The case will be prosecuted by Assistant U.S. Attorney Charles Baer on behalf of the United States Attorney's Office for the Southern District of Alabama. A copy of this press release may be found on the website of the United States Attorney's Office for the Southern District of Alabama at http://www.justice.gov/usao/als

Department of Justice

U.S. Attorney's Office
Southern District of Texas

José Angel Moreno • United States Attorney

FOR IMMEDIATE RELEASE

April 12, 2010

WWW.JUSTICE.GOV/USAO/TXS

ANGELA DODGE

PUBLIC AFFAIRS OFFICER

(713) 567-9388

## FORT WORTH MAN INDICTED FOR MAIL FRAUD ARISING FROM ALLEGED NATIONWIDE SCHEME TO SELL OVER $100 MILLION IN FRAUDULENT SECURITIES

(HOUSTON) – A federal grand jury in Houston has indicted George Douglas Black Sr., 41, of Fort Worth, Texas, for mail fraud arising from an alleged scheme to sell more than $100 million worth of worthless construction bonds for projects across the U.S., United States Attorney José Angel Moreno announced today.

The six-count indictment was returned this afternoon. The court is expected to set a date and to send notice to Black to appear for arraignment on the charges in the near future. Black, originally charged by criminal complaint, was arrested on Monday, March 29, 2010. Following a hearing before U.S. Magistrate Judge John Froeschner, Black was ordered released on bond on March 31, 2010, conditioned upon his discontinuing his bond business and not having any contact with any potential witnesses in the case.

The criminal complaint filed in federal court in Houston on March 25, 2010, alleges Black, not licensed or registered to sell securities, used the United States Mail to sell more than $25 million worth of bonds backed by a Tarrant County property valued in 2008 at $130,700 to numerous victims through his company, Infinity Surety. According to the allegations in the complaint, these bonds were used to insure various multi-million dollar construction projects.

The bonds, which allegedly represented that Black's Tarrant County property would fully protect the holder in the event of loss, were sold to school districts and defense businesses who did work for the military and other companies across the country including a $1.8 million bond sold to a company in the League City, Texas, area. The bonds were required for any public construction project as an insurance policy that is paid out if the contractors default or can't finish the work properly. The complaint alleges that a number of the construction projects in Louisiana dealt with Hurricane Katrina related repairs. A $19 million bond allegedly sold for repairs to the Beaumont Independent School District was for Hurricane Ike repairs.

Black's company, the complaint alleges, was being run out of a private mailbox in Saginaw, Texas. The victims paid Black significant fees for these bonds which they

believed protected their interests in various construction projects against loss, mailing Black approximately $2.8 million in fees for these bonds from 150 different companies throughout the United States. Today's indictment alleges more than $100 million in intended loss associated with these fraudulent bonds. Many of the bonds, according the complaint, were sold through Black's website, Infinitysurety.com.

According to the complaint, in July 2009 Black was enjoined by the state of Texas from selling bonds. Notwithstanding this injunction, Black allegedly sold at least $25 million worth of bonds over a period of a year. Black has allegedly been in the business of selling these bonds since 2006 and his website claimed these bonds were backed by "United States commercial and residential real estate." The complaint alleges that records obtained by the United States Postal Inspection Service (USPIS) showed this claim was false and that he routinely pledged the same small piece of property to insure multi-million dollar construction projects.

After Black's arrest, the state of Florida instructed Black to cease and desist selling the allegedly worthless bonds.

Each count of mail fraud carries a maximum sentence of 20 years in federal prison and a maximum fine of $250,000 upon conviction.

The investigation leading the charges was conducted by the USPIS and the Texas Department of Insurance. The case is being prosecuted by Assistant U.S. Attorney Ryan D. McConnell.

***An indictment is a formal accusation of criminal conduct, not evidence. A defendant is presumed innocent unless and until proven guilty beyond a reasonable doubt through due process of law.***

###

Everything New Orleans

# Houston officials charge George Douglas Black Sr. with mail fraud, alleging he peddled bogus bonds

Published: Tuesday, March 30, 2010, 6:31 PM Updated: Tuesday, March 30, 2010, 7:24 PM

By **Rebecca Mowbray, The Times-Picayune**

Federal law enforcement officials in Houston have arrested a Fort Worth, Texas, man for allegedly peddling bogus construction bonds on public works projects around the country, including many Hurricane Katrina rebuilding projects in the New Orleans area.

U.S. Attorney Jose Angel Moreno in Houston charged George Douglas Black Sr. with mail fraud for using the U.S. Postal Service to sell more than $25 million of worthless construction bonds through his company, Infinity Surety, over a period of one year.

The U.S. Department of Justice for the Southern District of Texas believes that Black sold fraudulent bonds to 150 different companies around the country to enable them to bid on public works projects and pocketed $2.9 million in fees. The bonds were supposed to protect taxpayers and ensure the proper completion of projects in the event that a construction firm went out of business, walked away from a project or did a lousy job on the work.

The millions of dollars of construction projects secured by Infinity Surety were backed by a home that Black owned in the Fort Worth area that was worth $130,700 and a few other small properties, meaning that local governmental bodies would have been in a jam had anything gone wrong with the jobs.

Black's victims include the Beaumont Independent School District in Texas and the U.S. Department of the Navy. The criminal complaint also cites a school in St. Tammany Parish and a project to build a new terminal at the Monroe Regional Airport.

In Louisiana, **according to state insurance officials**, projects to rebuild the cabins at Bayou Segnette State Park in Westwego, a community center in Plaquemines Parish, schools throughout the New Orleans area, the bathrooms at the Louis Armstrong International Airport, as well as a project demolish the former C.J. Peete public housing complex in New Orleans were all affected.

Locally, companies that used Infinity for bonding on jobs include Home Solutions of Louisiana, JRDKS Construction LLC, Benetech LLC, and Envirotech Services LLC, among others.

In some cases, government officials accepted Infinity Surety guarantees even though the company was unlicensed, putting taxpayers at risk and meaning that rival bidders with proper bond documents were unfairly denied work. In other cases, such as the Monroe Airport, low bidders with Infinity bonds were denied jobs, spawning lawsuits.

In July, the Texas Department of Insurance asked Infinity Surety to stop doing business because it was unlicensed. The Louisiana Department followed suit in December, obtaining a preliminary injunction from a Baton Rouge judge. The hearing for a permanent injunction is scheduled for the last week in April.

In the wake of the Infinity Surety scandal, Sen. Conrad Appel, a Republican from Metairie, has introduced Senate Bill 70 requiring public bodies to check with the Louisiana Department of Insurance to verify that companies providing bond insurance are licensed.

Kathy English, a public affairs officer for U.S. Attorney Jim Letten, could not confirm, deny or comment upon whether federal officials in New Orleans are also investigating Infinity Surety because of the local companies and local projects involved.

But an investigation in one district does not preclude an investigation into another, and Insurance Commissioner Jim Donelon said that his office has been working with Letten's office and the Federal Bureau of Investigation in New Orleans on the Infinity matter.

The Louisiana Department of Insurance also worked with federal law enforcement officials in the case of fraudulent bond broker Gwendolyn Moyo, who peddled bogus bonds and laundered the proceeds with former state Sen. Derrick Shepherd. Letten's office prosecuted the case, and Moyo has been sentenced to 20 years in prison, and Shepherd is serving 37 months.

In December, state insurance officials said that the Infinity Surety situation is probably larger than the Moyo situation.

Indeed, the criminal complaint in Texas suggests that Black probably sold more than the $25 million in bonds noted in the court filing, because the Justice Department only looked at one year's worth of transactions in its investigation. In reality, Black sold construction bonds from February 2006 until November 2009, according to the complaint.

Black listed his business address as a Pack and Ship Store in Saginaw, Texas, according to the criminal complaint.

He has asked for a public defender to represent him, and is being detained. A bail hearing is set for Wednesday. According to the complaint, Black has been arrested in Illinois, Nevada and Minnesota for offenses ranging from forgery to delivery of cocaine and marijuana.

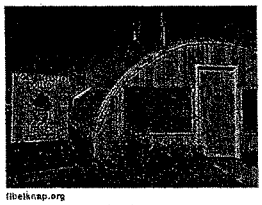
*Rebecca Mowbray can be reached at rmowbray@timespicayune.com or 504.826.3417.*

# Montana Adds to Fines Against Alleged Surety Con Artist

12/04/2012

By Erin Richey





fltbelknap.org

A greenhouse in part of the Fort Belknap reservation's college, where Dennis Lyon was the source of a surety bond.

The Montana Commissioner of Securities and Insurance has added $155,000 to the tally of fines racked up by an individual surety provider accused of violating insurance statutes in eight states.

Montana had previously fined Dennis Lyon $645,561 for supplying bid bonds and a performance bond without a license and with unverifiable backing assets, in 2004 and 2010. The state issued a permanent cease-and-desist order against Lyon in 2007. Similar orders prohibiting Lyon from selling bonds also exist in Texas, Oklahoma, Florida, Nevada, Washington, Maryland, and Georgia.

A portion of Montana's most recent fine, levied in October, includes $148,000 in restitution for Fort Belknap Tribal Construction on the Fort Belknap Indian Reservation, which paid bonding costs and fees to Lyon's unlicensed individual surety, Native American Funds Management Services.

It provided a performance bond on a contract to build an expansion to Fort Belknap College, the Aaniih Nakoda College. The commissioner alleges that Lyon, whose legal name is Robert Joe Hanson, received nearly $150,000 from the Gros Ventre and Assiniboine Tribes to provide the bonds.

A press release from the commissioner, Monica J. Lindeen, says Dennis Lyon also is known as Chief Joe Blue Eyes.

The college sought payment on the bond in June 2011; state records indicate the surety did not pay.

Lyon has yet to pay any fines in Montana. Neither he nor Fort Belknap Tribal Construction could be reached for comment.

Lucas Hamilton, communications director for the commissioner, says that the fines represent the limit of the state's ability to punish Lyon, since they cannot revoke a license he never had in the first place. Hamilton adds that it is difficult to root out such violations without tips from concerned consumers.

"There's no real proactive way we can get ahead of him," Hamilton says of Lyon.

Individual surety bond fraud on federal contracts has recently regained the attention of the U.S. Congress, where the House of Representatives last May passed the Security in Bonding Act of 2012. Known as H.R. 3534, the act proposes to set tighter standards for the types of assets that may be used to back an individual surety bond. Action in the Senate could occur in the spring or summer.

For contractors seeking a surety bond, Hamilton recommends calling a state department of insurance to verify that the person selling the product is licensed.

"It would have made a big difference had we gotten that call before the Fort Belknap reservation went ahead with surety bonds."

Keywords: Individual; Surety; Bond; Montana; Belknap; College; Lyon; Hanson; Reform

Related Links:
- ENR Editorial: Why Bond Assets Need Scrutiny
- GovTrack Page on H.R. 3534
- Montana Commissioner of Securities and Insurance press release

Statement of

Mr. Thomas J. Kelleher, Jr., of Smith Currie & Hancock LLP

on behalf of

The Associated General Contractors of America

to the

**Subcommittee on Contracting and Workforce**

Committee on Small Business

U.S. House of Representatives

For a hearing on

**"Building America: Challenges for Small Construction Contractors"**

May 23, 2013

AGC of America
THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
**Quality People. Quality Projects.**

**The Associated General Contractors of America (AGC) is the largest and oldest national construction trade association in the United States. AGC represents more than 33,000 firms, including 7,000 of America's leading general contractors, and over 12,000 specialty-contracting firms. Over 13,000 service providers and suppliers are associated with AGC through a nationwide network of chapters. AGC contractors are engaged in the construction of the nation's commercial buildings, shopping centers, factories, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, water conservation projects, defense facilities, multi-family housing projects, site preparation/utilities installation for housing development, and more.**

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**Statement of Thomas J. Kelleher, Jr.,**
**Smith Currie & Hancock LLP; Atlanta, Georgia**
**Subcommittee on Contracting and Workforce**
**Committee on Small Business**
**United States House of Representatives**
**May 23, 2013**

My name is Tom Kelleher. I am a Senior Partner with the law firm of Smith Currie & Hancock, where I lead our national construction law practice, which is focused on federal construction. I regularly counsel federal contractors on a wide variety of small business issues, including advice on affiliation rules; mentor-protégé programs; small business and set-aside strategy and compliance (8(a) contracting, ANC, NAC, HUBZone, SDVOSB); small business subcontracting plan compliance; and small business size protests. I previously served as Chair of the Federal Acquisition Regulation Committee for the Associated General Contractors of America ("AGC") and remain active in the leadership of AGC's Federal & Heavy Construction Division. In addition, I previously wrote and am currently updating AGC's book on federal government construction contracts that includes an extensive analysis of the federal small business construction program. I testify today before the Committee on behalf of AGC and its members on the topic of small business utilization in federal contracting and potential reforms that may improve the government's efforts to utilize and develop small businesses.

AGC strongly supports full and open competition for the many contracts necessary to construct improvements to real property. AGC works to foster a business climate that provides opportunities for all small businesses. To succeed, construction firms must focus on price, quality and reliability. Construction is an intensely competitive industry, and we believe that full and open competition properly penalizes any firm that discriminates based upon impermissible factors. Competition energizes and improves the construction industry, which benefits the economy as a whole. Full and open competition is especially important during these trying economic times.

Despite a recent, modest upturn in construction employment, payroll employment in April 2013 was nearly 2 million, or 25 percent, below the peak in 2006, and unemployment in the sector remains deplorably high. The industry's unemployment rate in April 2013 was 13.2 percent, not seasonally adjusted—the highest of any industry and nearly double the overall unemployment rate, according to data the Bureau of Labor Statistics released on May 3, 2013. Although demand for private nonresidential and multifamily construction has revived modestly, federal construction spending is down 28 percent since August 2011 according to the U.S. Census Bureau. The outlook for public construction remains grim as agencies at all levels of government continue to cut construction spending.

AGC supports procurement reform to improve delivery of federal construction services. Reform of the federal procurement process should recognize construction's unique blending of diverse industry sectors. It should also recognize the limitations of what the market can provide, as well as consider the cost versus benefit to the public sector and taxpayers.

Our members recognize the potential benefits that federal small business programs – including the 8(a) Business Development Program, HUBZone Program, Veteran Owned and Service Disabled Veteran Owned Small Business Programs, tribally-owned contracting programs, and Woman Owned Small Business Program – provide to contractors who qualify for these programs. However, the programs as currently regulated, do not achieve the important goal of developing successful small companies that can compete and succeed on their own. In AGC's view, the rules need to be reformed so that contractors may: (1) comply with the rules; (2) reasonably predict what actions are compliant with the rules and (3) meet the requirements of their federal agency customer more efficiently. AGC believes that the current rules encourage firms to structure their performance in a way that technically meets legal requirements yet fails to capture the spirit and real intent of the small business programs.

To help ensure that the small business program works to successfully grow America's small businesses, AGC proposes:

(1) Allowing lower tier small business subcontracts to count toward small business prime contractors' subcontracting goals to improve transparency and provide more accurate data regarding the extent of small business participation in the federal construction program; and

(2) Prohibiting federal agency procurement of construction services through reverse auctions to ensure that small construction businesses can successfully compete for federal government contracts.

In addition, AGC holds that reforms to design-build procurement and surety bonding requirements can also be made to help allow the program to work as intended.

**Count Small Business Subcontracting At All Tiers**

The construction industry has historically supported and provided opportunities for small businesses. Construction is usually accomplished under the leadership of a general contractor. It is the job of the general contractor to integrate the work of the numerous trade and specialty contractors to complete the project. It is not unusual to have anywhere from 20 to 50 trade and specialty contractors on a significant construction project. These subcontractors are organized within the project delivery team in tiers so that each subcontractor can deliver its services in a highly integrated process. Small business trade and specialty subcontractors, operating at the appropriate tiers, are critical and essential to the success of construction projects and the construction industry as a whole. The construction industry cannot succeed without a large pool of qualified small business trade and specialty subcontractors.

This industry is proud of its efforts to include small businesses and allow small businesses to develop. However, instead of being rewarded for its efforts, agencies often over rely on the construction industry to shoulder the burden for other industries that have not encouraged small business involvement. Agencies try to meet substantial portions of their goals by limiting competition to small businesses and their subsets in construction.

A consequence of this practice causes another disturbing trend: Massive growth in the percentage of small business construction subcontracting goals. In some cases, our industry has seen small business subcontracting goal requirements exceed 70 percent on large projects. Large general contractors are usually able to meet the strict legal requirements to achieve these goals, but only through a combination of complicated, inefficient project administration maneuvers and substantial use of larger businesses working as subcontractors to small businesses. These techniques, while legal, do not help most small business actually gain the experience to grow and succeed as the federal small business program intends.

Rather than force unrealistic goals on very large projects where an extremely high level of small business subcontracting at the first tier level is simply not feasible, the government should adapt its agency-wide goals and subcontracting goals to be more consistent with what the market can provide. Counting lower tier small business subcontractors can help Congress and federal agencies make more informed decisions to the small business program, thereby ensuring that small businesses gain the experience they need to grow and succeed.

How the Current System Fails to Account for True Small Business Participation

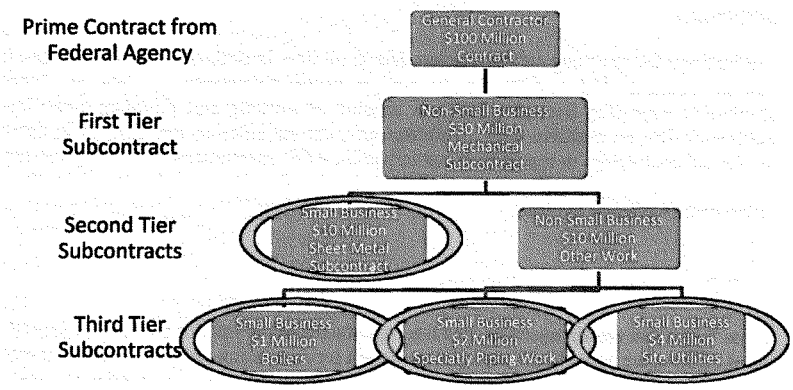
Current rules require set-asides for small business subcontractors, but prohibit general contractors from truly accounting for the total amount of dollars flowing to small businesses. As it stands, if a non-small business is included as a first tier subcontractor, a prime contractor is disqualified from reporting further dollars going to small businesses at lower tiers. Although the rules allow subcontractors to report this information to general contractors, it is the general contractors' experience that subcontractors very infrequently report such information, as there is no incentive for or penalty against the subcontractors to make this effort. As a result, unfortunately, these current counting rules provide an incomplete picture of true small business participation.

Implementing our recommendation can help bring greater transparency to small business subcontracting goals as shown in the following example:

- An agency procures a $100 million building to be constructed. One of the first tier subcontracts is for all the mechanical trades to be performed in the structure. The prime contractor awards that first tier subcontract valued at approximately $30 million to a non-small business, as no qualified mechanical small businesses are available to manage that contract. That first tier small business contractor, in turn, subcontracts $10 million in sheet metal work plus another $7 million in boilers, piping and utility work to second tier small businesses.
- The current law prevents the general contractor from counting the $17 million second, third and subsequent tier small business work, as that work is beyond the first tier. If the first tier subcontractors are non-small business contractors, as is the case here, the counting and reporting stops there. That is true even though the sheet metal and other lower tier subcontractors are small businesses. On a typical large construction project there are many qualified specialty trade small businesses operating at lower tiers, but

their participation is not allowed to be counted and the true value and role of small business in federal construction is underrepresented.

- The diagram below depicts the example discussed above. Under the current rules, the small business contracts circled below are not counted towards a general contractor's small business subcontracting goals. In this example, $17 million in small business subcontracts would not be counted towards the subcontracting goal and the government may have no record of this degree of small business participation. It is our experience that large business subcontractors do not understand or properly complete small business subcontracting reports, since there is no incentive for or penalty against the subcontractors to make this effort.




The Benefits of Counting Small Business Subcontractor Participation at All Tiers

Allowing prime contractors to report small business subcontracting at all tiers would demonstrate true small business participation on a federal contract. Consequently, Congress and federal agencies could determine where small businesses are underrepresented and make informed improvements to the small business program.

In addition, this reform would help ensure that small businesses actually gain the experience the program intends for them to get through the enactment of these goals. As it stands, many prime contractors elevate small business subcontractors that usually work at lower tiers to the first tier to help meet current small business subcontractor goals. Oftentimes, those small business subcontractors then join with non-small businesses, which actually perform a significant amount of the work and have the bonding capacity to guarantee that work. As a result, much of the work experience the small business program intends for a small business subcontractor to gain is actually passed through to non-small business contractors.

Federal agency source selection requirements incentivize prime contractors to allow these pass-through situations to occur because agency small business participation plans, subcontracting plans and past performance evaluations are an important element in the project award process. Small business participation at the subcontractor level noted in these plans is something agencies consider in their determination to make a current award. Additionally, the prime contractor's ability to meet those goals are included in past performance evaluations used in consideration for future federal work. By enabling prime contractors to count lower tier small business contractors towards small business goals, prime contractors can encourage qualified small business subcontractors to participate at a level they are most capable to actually perform the work and succeed by gaining the experience the federal small business program intended them to gain.

The Federal Government Already Uses Tracking Technology That Can Count Lower Tier Subcontractors

The technology for reporting subcontracting data at all tiers is already available and used by the federal government. The system already used to report subcontracting data, the Electronic Subcontractor Reporting System (eSRS), is capable of tracking and reporting small business subcontractor data on multiple tiers. Unfortunately, current rules do not adequately encourage lower tier subcontractors to report their participation. AGC recommends that Congress legislate to allow prime contractors to count small business involvement at all tiers using the eSRS reporting system already in place.

**Prohibit Reverse Auctions for Construction Services**

AGC has found that certain agencies, like the Department of the Interior and Department of Veterans Affairs, are actively procuring construction services using reverse auction procurement under the unproven conclusion that they save taxpayer dollars. Vendors promoting reverse auctions have yet to present persuasive evidence that reverse auctions will generate real savings in the procurement of construction or will provide benefits of "best value" comparable to currently recognized selection procedures for construction contractors, which have been carefully and specifically tailored for all types of construction.

Manufactured goods—like pens and paper—are subject to little or no variability or change in manufacture or application. Construction projects, on the other hand, are inherently variable. Each is subject to the unique demands of the project, such as the needs, requirements, personnel and budgetary criteria of the owner, site conditions, design features and parameters, and the composition of the project team. Federal procurement laws recognize that construction stands apart from commodities or manufactured goods.

AGC contends that vendors who suggest reverse auctions for construction services misuse a procurement process originally designed for commodities. It ignores the unique nature of construction. Construction contractors, specialty contractors, subcontractors and suppliers offer and provide a mix of services, materials and systems. They do not "manufacture" buildings, highways, or other facilities. In fact, the construction process is fundamentally different from the manufacturing process.

This distinction was reiterated in a July 2003 memorandum from the Office of Federal Procurement Policy (OFPP), which states that "...construction projects and complex alteration and repair, in particular, involve a high degree of variability, including innumerable combinations of site requirements, weather and physical conditions, labor availability, and schedules." This memorandum was sent to all federal procurement executives, advising them not to treat construction as a commodity for government procurement purposes.

Reverse Auctions Do Not Guarantee Lowest Price

In the context of construction, AGC believes that most of the claims of savings are unproven and that reverse auction processes may not lower the ultimate cost of construction. For example, "winning" bids may simply be an established increment below the second lowest bid not the lowest responsible and responsive price. Moreover, in reverse auctions, each bidder recognizes that he or she will have the option to provide successive bids as the auction progresses. As a result, a bidder has little incentive to offer its best price and subsequently may never offer its lowest price. In addition, savings from reverse auctions can be one time occurrences.

Reverse Auctions May Encourage Imprudent Bidding

Reverse auctions create an environment in which bid discipline is critical yet difficult to maintain. The competitors have to deal with multiple rounds of bidding, all in quick succession. The process may move too quickly for competitors to accurately reassess either their costs or the way they would actually do the work. If competitors act rashly and bid imprudently, the results may be detrimental to everyone, including the owner. Imprudent bidding may lead to performance and financial problems for owners and successful bidders, which may have the effect of increasing the ultimate cost of construction as well as the cost of operating and maintaining the structure.

Negotiated Procurements Allow Thorough Evaluation of Value

Where price is not the sole determinant, federal owners increasingly have utilized processes focused on negotiation to expand communication between the owner and prospective contractors for the purpose of discussing selection criteria such as costs, past performance and unique needs. These processes recognize the value and quality of project relationships that promote greater collaboration among the owner and project team members. These processes also consider quality, safety, system performance, time to complete and overall value that can, in fact, outweigh the lowest price to arrive at the best value for the owner. Such an approach offers both the owner and contractor the opportunity to discuss and to clarify performance requirements of the project.

On the other hand, reverse auctions do not promote communication between the owner and bidders. Rather, they promote a dynamic in which bidders repeatedly attempt to best each other's prices. In fact, reverse auctions between buyers and suppliers often have a deleterious effect on the relationship between buyer and seller. Non-price factors of consequence to the owner, such as quality of relationship, past performance, and unique needs, are deemphasized in the auction. As a result, reverse auctions do not offer owners a good way to evaluate non-price factors.

Sealed Bidding Assures that the Successful Bidder is Responsive and Responsible

Where price is the sole determinant, the sealed bid procurement process is well-established to ensure integrity in the award of construction contracts. Under sealed bid procurement, each bid is evaluated through the use of objective criteria that measure responsiveness of the bid to the owner's articulated requirements and the responsibility of the bidder. In this manner, sealed bidding ensures fairness and value for the federal owner. On the other hand, reverse auctions ignore this tradition. The pressure and pace of the auction environment removes any assurance that initial and subsequent bids are responsive and material to the federal owner's articulated requirements. These auctions expose federal owners to the real possibility that they may award contracts to what would otherwise be non-responsive bidders. In addition, reverse auctions ignore the protections of the sealed bid procurement's laws, regulations and years of precedent that address these critical factors and ensure the integrity of the process.

Reverse Auctions may Contravene Federal Procurement Laws and Certain State Laws

Federal procurement laws do not specifically address the use of reverse bid auctions to procure construction. The Federal Acquisition Regulation (FAR) and current procurement statutes, however, do reflect a clear policy of not disclosing contractor price information. Price disclosure is often a distinguishing feature of reverse auction processes. Given the restrictions on contractor price disclosure in the U.S. Code and the FAR, it is unclear that any authority exists for the federal government to conduct reverse auctions on fixed-price type contracts or that current law can be interpreted to permit the practice of reverse auctions by the federal agencies. In addition, some states, such as Pennsylvania and Kansas, have enacted statutes that prohibit procurement of construction through reverse auctions.

The Government Experience Does Not Support the Use of Reverse Auctions for Construction

AGC strongly recommends that the Committee closely examine the findings of a reverse auction pilot program report that the Army Corps of Engineers (USACE) issued on July 26, 2004. The findings of the report clearly show that reverse auctions are an inappropriate tool to procure construction and construction-related services. The report further states that reverse auctions fail to realize any additional savings over the sealed bid process.

In its final determinations, USACE found that the acquisition of construction services cannot and should not be equated with commodities for the following reasons:

- Within the operational parameters of Department of Defense contracting regulations, the dynamics are much too diverse between [construction services and commodities]; and
- Virtually all of the USACE construction services...are one-of-a-kind projects under one-of-a-kind conditions with numerous and consistent variables for cost and no-cost factors.

The USACE report stated that there was no proof that reverse auctions provide any significant or marginal edge in savings over the sealed bid process for construction services, noting:

- There was no proof that a consistent, reliable and valid measurement method for projecting savings could be established from reverse auctioning;
- Absent any specific price history for an identical project under identical conditions, there is no practical way to measure or compare any projected savings by reverse auctions over sealed bidding; and
- There is no proof reverse auctions provided any significant or marginal savings in comparison to the government estimate.

Additionally, on March 6, 2008, Major General Ronald L. Johnson, former Deputy Commanding General of USACE, testified before this Committee on this very issue. MG Johnson testified that "The Corps, through our pilot study, found no basis to claim that reverse auctioning provided any significant or marginal savings over a traditional contracting process for construction or construction services." MG Johnson also testified that "[w]hile this tool may be appropriate and beneficial in more repetitive types of acquisition, we did not find it to be a useful tool for our construction program and do not currently utilize it today to any great extent."

For these reasons, AGC supports legislation prohibiting reverse auction procurement for construction and construction-related services.

**Design-Build Procurement & Security in Bonding**

AGC Supports Two-Step Design Build as the Preferred Design-Build Procurement Process

AGC supports federal agency use of the two-step design-build procurement method as the preferred method over single-step design-build procurement for construction projects. The two-step process involves two rounds of construction and design team selection. Generally, during the first round, a large number of construction and design teams submit their qualifications for the project. Based on those qualifications, the federal agency selects three to five teams to submit full proposals, including extensive and expensive design materials, for final selection in the second round. AGC has long held and supported the limitation of the second round selection to three to five finalist teams.

In the single-step process, on the other hand, there is no qualification first round. Rather, all construction and design teams must submit full proposals, which can cost millions of dollars depending on the size of a project. As a result, competition suffers because many qualified teams, especially small businesses, choose not to incur large costs to participate in single-step design build procurement where perhaps 20 teams or more can compete. Why spend those proposal dollars for a 1 in 20 chance, when you can enter a two-step procurement, reach the second round and have a 1 in 5 or better chance of winning the award?

As such, agencies should strive to limit single-step design-build procurement to less complicated and less expensive projects, where very little design work is required. AGC does not support the complete elimination of the single-step design-build procurement by federal agencies, but rather the sensible use of that particular procurement method for smaller construction projects.

AGC Supports "The Security in Bonding Act of 2013" (H.R. 776)

The Miller Act provides statutory surety bond requirements that protect federal project owners by assuring: (1) that interested contractors have been prequalified by a corporate surety to perform a construction contract; (2) that a reputable and knowledgeable corporate surety stands ready to complete the contract in the event of contractor default; and (3) that project subcontractors and suppliers will be paid. Individual sureties, however, may neither be subject to the same regulatory oversight as corporate sureties, nor are they required to relinquish the custody and control of the assets that they pledge to secure their bonds on federal construction projects.

The Security in Bonding Act, H.R. 776, would help eliminate future instances where individual surety bonds are pledged with insufficient or illusory assets. This would help level the playing field for all contractors when it comes to surety choices and better protect the federal government from the risk of default.

**Conclusion**

Thank you for the opportunity to provide our views on working with the federal market. For the reasons stated above, AGC strongly recommends that Congress reform the federal procurement process to (1) count lower all tier small business subcontractors towards small business subcontracting goals; and (2) prohibit reverse auction procurement for construction services.

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## Interior May Drop Sub Listing Provision

In Nov. 1965, the Dept. of Interior adopted a detailed *subcontractor listing* requirement designed to prevent construction contractors from "shopping" for subs—after submission of bids—who would perform work at lower prices than the subcontract prices on which the prime contractor based his bid to the Govt (see 7 G.C. ¶ 535).

Interior now reports that its experience with these sub listing provisions over the last ten years has shown that the requirement has had the following adverse effects:

(1) It has exposed the Govt to liability for *damages*, as demonstrated in *MevA Corp. v. U.S.*, Ct. Cl. (19 Feb. 1975), 17 G.C. ¶ 110.

(2) Bidders have had difficulty in understanding and complying with the requirement, thereby often leading them to submit *nonresponsive* bids (and depriving the Govt of the benefit of what would otherwise have been the low responsive bid). [NOTE—Although not cited by Interior, a very recent example of such a sub listing nonresponsiveness situation involving one of its agencies is Comp. Gen. Dec. B-183077 (25 Apr. 1975), Unpublished, 75-1 CPD ¶ 262.]

(3) The numerous protests filed with the Comp. Gen. in connection with this requirement have resulted in considerable *delay* in award and performance of important contracts.

(4) Bidders under present economic conditions find it difficult to get firm advance bids or quotations from prospective subcontractors. They are therefore put at a disadvantage when they have to negotiate a subcontract price with the listed subcontractor after prime contract award.

(5) The listing requirement does not prevent "bid shopping" by *subcontractors*.

In view of the above factors, Interior proposes eliminating the sub listing requirement from its regs. (40 Fed. Reg. 17848)

★ **Note**—Adoption of the above proposal would leave GSA as the only major Govt agency maintaining a sub listing requirement. See GSPR 5B-2.202-70. While GSA does not presently seem to be taking any active steps to drop its own version of the requirement, Interior's action in (and reasons for) doing so, and the failure of any other agencies to adopt such a program in the past ten years, may eventually weaken GSA's commitment to the listing program.

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## GSA Board Will Hear And Decide Appeals Under Civil Rights Commission Contracts

The U.S. Commission on Civil Rights has designated the General Services Administration Board of Contract Appeals (GSBCA) as its authorized representative to hear and determine appeals taken from final decisions of the Commission's Contracting Officers on disputed questions arising under its contracts. Effective date of this designation is 30 Apr. 1975.

★ **Note**—The GSBCA is also currently authorized to determine contract appeals from such other non-GSA agencies as the Treasury Dept., the Pennsylvania Ave. Development Corp., and the Overseas Private Investment Corp.

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## Task Group Extends Support To Proposals Regarding Boards And Appeals Therefrom

A Govt Executive Branch Interagency task group has proposed adopting the following recommendations to Congress made by the Commission on Govt Procurement (40 Fed. Reg. 17788):

(1) *Multiple* procuring agency contract appeal *Boards* should be *retained* and (a) be given *subpoena* and *discovery* powers, and (b) have *minimum standards* developed for their personnel and caseload. In endorsing this recommendation, the task group feels it vital that the Boards be *full time tribunals* with *full time members* who are *all attorneys*.

(2) *Both* the *Govt* and contractors should be permitted to obtain *judicial review* of adverse Board decisions. To avoid excessive Govt appeals, the task group recommends that any such Govt appeal require the joint concurrence of the procuring agency head and the Justice Dept. [NOTE—Adoption of this recommendation would in effect reverse the result reached in *S & E Contractors, Inc. v. U.S.*, 406 U.S. 1, 14 G.C. ¶ 182. The task

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Std. Form 254 *(A-E & Related Services Questionnaire)* and Std. Form 255 *(A-E & Related Services For Specific Project)*.

The new forms require more detailed data than the old one regarding an A-E firm's size, capabilities, organization and past experience. Std. Form 255 is designed to supplement Std. Form 254 and to obtain specific detailed information on the prospective firm's qualifications for a particular project. It must be used whenever the fee for a project is expected to exceed $10,000 (although the form can also be used for smaller projects when it is in the Govt's best interest to do so).

The new forms apply to A-E procurement related to the construction of buildings, bridges, roads or other kinds of real property. They are not required in procurements related to construction of vessels, aircraft or other kinds of personal property. (FPR Amendment 150, 40 Fed. Reg. 30440)

¶ 306

## Interior Drops Subcontractor Listing Clause

In Nov. 1965, the Dept. of Interior adopted a detailed subcontractor listing requirement designed to prevent construction contractors from "shopping" for subs—after submission of bids—who would perform work at lower prices than the subcontract prices on which the prime contractor based his prime contract bid to the Govt (see 7 G.C. ¶ 535).

However, its experience with these sub listing provisions over the last ten years has convinced Interior that they are disadvantageous in a number of key respects (see 17 G.C. ¶ 188 for a full description of these adverse effects). Consequently, Interior has now eliminated the sub listing requirement from its regs. (40 Fed. Reg. 29722)

★ **Note**—The above deletion leaves GSA as the only major Govt agency maintaining a sublisting requirement. See GSPR 5B-2.202-70. While GSA does not presently seem to be taking any active steps to drop its own version of the requirement, Interior's action in (and reasons for) doing so, and the failure of any other agencies to adopt such a program in the past ten years, could possibly eventually weaken GSA's own commitment to the listing program.

## CASES AND DECISIONS

¶ 307

**Court Splits Damages Where Both Contractor And Govt Were At Fault.**—At an earlier stage of this case, a procuring agency contract appeals Board found that the specifications of the contract to furnish an antenna system were defective. However, it also found that contractor had the *means* of knowing about those defects before award and acquired *actual* knowledge no more than a few days after award. It therefore concluded that, by voluntarily choosing to experiment with new production methods without notifying the Govt until nine months later, contractor *assumed the risk* of the failure of its experimental program and was not entitled to relief from the Govt's default termination of the contract.

On the other hand, the Board found that the system which the Govt purportedly reprocured from another firm following the termination was *not similar* to the defaulted contract item and that the Govt was therefore not entitled to recover from contractor the excess costs of this purported reprocurement. See ASBCA 11766, et al., 11 G.C. ¶ 487.

In reviewing the above decision, the Court agrees with the Board that—by failing to give the Govt notice and request a change order—contractor *waived* its right to claim that *some* of the contract defects excused its default. However, there were *other* defects *independent* of the above which contractor did not recognize as such until it had exhausted all alternative methods of performance, and contractor did *not* waive its claim with regard to these defects. Instead of relaxing the specifications when contractor notified it of these latter defects, the Govt (1) insisted that contractor perform the defective design-type specifications, and (2) thereby assumed the risk that these specifications were non-performable (i.e., were beyond the state of the art).

The present case thus involves a situation where *both* parties were at *fault* (in the sense that each was responsible for some of the defects, any of which would by themselves have prevented

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¶ 59

## Interior Proposes Regs Supplementing FAR

The Dept. of Interior has proposed to adopt a set of regs to implement and supplement the new Federal Acquisition Regulation (FAR) system (see 25 G.C. ¶ 298). The proposed provisions (which would replace the current Interior procurement regs) would be known as the Dept. of Interior Acquisition Regulations (DIAR's) and be codified as Chapter 14 of Title 48 in the Code of Federal Regulations (CFR's).

Interested persons may, until 14 Mar. 1984, submit written comments on the proposed regs to the Acquisition & Grants Division, Office of Acquisition & Property Management, Interior Dept., 18th & C Streets, N.W., Wash., D.C. 20240. (49 Fed. Reg. 5472)



¶ 60

## GSA Drops Subcontractor List Provision —CONTRACTOR Prediction Proves Correct

In 1963, GSA adopted a detailed subcontractor listing requirement designed to prevent contractors from "shopping" for subs who—after submission of bids—would perform work at lower subcontract prices than the ones on which the prime contractor had based his bid to the Govt (see 5 G.C. ¶ 423). Although the Interior Dept. followed GSA's lead by adopting its own version of the clause in 1965 (see 7 G.C. ¶ 535), Interior ultimately dropped its version ten years later (see 17 G.C. ¶ 306).

In view of the fact that (1) this left GSA as the *only* major Govt agency maintaining a sub listing requirement, and (2) *no other* agency had adopted such a program in the *intervening ten years*, we predicted (in a NOTE at 17 G.C. ¶ 306) that GSA's *own commitment* to the list program would *eventually weaken*. Our prediction has now been fulfilled. On 15 Feb. 1984, GSA *entirely dropped* its sub listing requirement for the purpose of (among other things) establishing *uniformity* with other Govt agencies and eliminating the delays and financial losses which have resulted from the requirement. This action, believes GSA, will not cause (a) prime contractors to now begin bid shopping or obtain a windfall at the expense of the Govt or subs, or (b) subs who were previously covered by the listing requirement to now provide inferior work.

At the same time, GSA added a "Subcontractor Eligibility" clause (to be included in all building construction, alteration and repair contract solicitations) which will generally prohibit prime contractors from subcontracting with any firm which is on the Govt's list of debarred, suspended and ineligible contractors.

Full text of the above actions is set forth at

49 Fed. Reg. 5754.

★ **Note**—Listing of subcontractors is sometimes required for *reasons other* than the avoidance of *bid-shopping*. For example, they are sometimes inserted in a bid solicitation to permit evaluation of the bidders' ability to meet the solicitation's *equal employment opportunity* provisions. Despite the above GSA action, therefore, contractors will continue to occasionally encounter such clauses and need to remain aware of legal decisions on the subject.

One of the more recent ones is Comp. Gen. Dec. B-206442 (17 Mar. 1983), 83-1 CPD ¶ 271, holding that—where a sub listing requirement was included for equal employment opportunity purposes—the contracting agency (a local housing authority) could reject the low bidder as *nonresponsible* where he failed to adequately demonstrate his proposed sub's ability to meet the solicitation-specified hiring goals for women and minorities.

¶ 61

## FPR Cost Principle Modifications Published

Several important FPR costs principles were recently modified to conform to corresponding revisions of the DAR. The changes cover these subjects (48 Fed. Reg. 56380):

**A. Insurance**—The cost of insurance to protect contractor against the costs of correcting its own defects in materials or workmanship is made unallowable in revised FPR 1-15.205-16.

**B. Engineering**—FPR 1-15.205-21 is modified to expand the list of activities included in the definition of manufacturing and production engineering. Specifically, the revised cost principle covers the allowability of development efforts for manufacturing or production systems, equipment, processes, methods and tools that are not intended for sale.

**C. Personal Services Compensation**—Significant changes in FPR 1-15.205-6 include the following:

(1) The number of general criteria which must be met in order for compensation to be allowable has been increased from two to five.

(2) Even where *total* compensation for personal services is considered reasonable (because it conforms generally to compensation paid by other firms of the same size in the same industry or in the same geographic area for similar services), the Govt will not be barred from challenging the reasonableness of an *individual element* of compensation (where the individual element's costs are excessive in comparison with costs paid by other firms). In questionable cases, contractor will have the responsibility of showing that compensation was reasonable in relation to the effort performed.



(3) Severance payments are made unallowable when they are in addition to early or normal retirement payments.

(4) Restrictions are placed on the allowability of costs associated with stock options, stock appreciation rights, phantom stock plans, employee stock ownership plans, and pay-as-you-go pension plan methods.

(5) Henceforth, total allowable costs for early retirement plans may not exceed an employee's annual salary for the prior year. In addition, such plans must be accounted for as pension costs.

★ **Note**—Many of the corresponding DAR changes in the personal services compensation cost prin-

★ THE GOVERNMENT CONTRACTOR

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# THE AMERICAN INSTITUTE OF ARCHITECTS

STATEMENT OF
HELENE COMBS DREILING, FAIA
2013 FIRST VICE PRESIDENT

***"Procurement Issues and Solutions for Federal Design-Build Construction"***

United States House of Representatives
Committee on Small Business

-

May 23, 2013
2360 Rayburn House Office Building

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## Introduction

Chairman Hanna, Ranking Member Meng, and members of the Committee, I am Helene Combs Dreiling, FAIA, Executive Director of the Virginia Center for Architecture and the 2013 First Vice President of the American Institute of Architects (AIA). I want to thank you for the opportunity to testify today on behalf of the AIA and its more than 81,000 members.

## Federal Design Build Construction

The current economic crisis has affected every American, but, as this Committee knows all too well, it has hit small businesses and the design and construction industry particularly hard. Architects are, by and large, small business people; 95 percent of U.S. architecture firms employ 50 or fewer people.[1] In fact, the vast majority practice is one or two person firms. The recession has accelerated this trend as medium sized firms have been purchased by large firms, and some architects, having been laid off by their firms, have begun their own businesses.

The health of the architectural profession matters greatly to the overall state of the economy. Architects are the starting point for the design and construction industry, which accounts for one in nine dollars of U.S. gross domestic product.

Architects are job catalysts—they are the first workers to be involved in the construction process when they develop designs for homes, offices, retail spaces, hospitals, educational institutions, government buildings, and more. Hiring an architect leads to employment in other construction-related fields, from engineers and manufacturers, to steel and electrical contractors. In fact, there is one architectural service worker for every 34 construction industry workers in this country,[2] creating over $1 trillion in economic activity in 2008.[3] A study by the George Mason University Center for Regional Analysis found that every $1 million invested in design and construction creates 28.5 new full-time jobs.[4]

Recently there has been good news on the unemployment front for the construction industry, but the recovery seems to be fragile at best. The most recent job numbers show that the construction industry lost 6,000 jobs last month [5] even when the unemployment rate dropped. Because of a lack of financing in the private market since the start of the economic crisis in 2008, public sector work has literally been a lifeline for many small design firms. Government procurement, including at the federal level, has helped to keep the doors open at numerous firms across the nation. However, small firms are losing some of the contracts available because larger firms are "bottom feeding." They are going after projects they never would have even considered several years ago just to pay their bills. In addition, clients are also negotiating fees downward,

[1] http://info.aia.org/aiarchitect/thisweek09/1009/1009b_firmsurvey.cfm
[2] U.S. Department of Labor
[3] www.census.gov/const/C30/total.pdf
[4] www.naiop.org/foundation/contdev.pdf
[5] http://money.cnn.com/2013/05/03/news/economy/construction-jobs/index.html (last visited on May 16, 2013)

using the threat that they can always find someone to do the project for a greatly reduced price.

These factors, coupled with smaller construction budgets at federal agencies, have severely intensified the competition for federal contracts. This struggle has given the federal government undue strength in the negotiations and has enabled them to demand more from candidates. Although competition helps ensure that the taxpayer receives good value, there is a difference between getting a fair deal for the government and a procurement process that forces architects, engineers, contractors, subcontractors and suppliers to spend more money for a smaller chance of getting the job. The taxpayer does not win when government contracting leaves small businesses in difficult economic straits.

**Design Build Construction**

Federal agencies are able to use a number of different project delivery methods to design and construct buildings, including design-bid-build, design-build, and joint ventures, among others. These methodologies allow agencies the flexibility to choose the right method for a specific project. According to a survey by the AIA Large Firm Roundtable, almost 66 percent of all domestic buildings from 2007 through July 2011 were built using the design-build method.[6]

When agencies choose design-build, they post a solicitation on Fed Biz Ops. Interested teams, typically comprised of an architect, engineer, contractor and subcontractors, submit their qualifications to the pre-selection board. In this first step, the board will review the teams' qualifications, which include past performance, resumes of key personnel, and examples of relevant projects, to create a short list for the second step in the competition.

At this point, the short-listed teams develop a more in-depth proposal based on the programmatic requirements within the solicitation. In order to develop an accurate cost, teams must complete approximately 80 percent of the design work in advance. The design work is considerable, as each team must determine space needs; mechanical, electrical, HVAC and other systems; building supplies and materials; and the cost of construction. Without this information, there is simply no way to determine a final price. This design work takes a considerable amount of time from the large group of professionals on each team, which places enormous economic burdens on each design-build team on the short list.

**Design-Build Competition Issues**

Another procurement issue small design firms face is the financial burden of the federal design-build construction process on architects. On average, the federal design build fee is approximately $1.5 million[7]. The rewards are high for these projects, but the cost to enter the federal market is increasingly prohibitive for small firms.

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[6] AIA Large Firm Roundtable, *Competition Survey Results,* May 31, 2012 at 9.
[7] Ibid at 9.

When teams are shortlisted in two-step design-build, an architecture firm spends a median of $260,000 to compete for a design-build project, by making plans, models and other materials.[8] In almost 87 percent of federal design-build competitions, there are no stipends provided to the architectural firm.[9] The firm must hope that they win, with their team, to make up the costs they expend in competing for the job.

When teams decide whether to compete for a design-build project, they weigh the costs of competing with the odds of winning. Agencies have taken advantage of their purchasing power during the recession to expand the number of short-listed teams. In the past, agencies would typically shortlist three teams for a design build project. Now, there are reports that some agencies are shortlisting as many as eight-to-10 teams. In these cases, the odds of being selected drop significantly, even as the cost to compete continues to rise. This is an especially difficult situation for small firms, which are less able to absorb the costs of competitions than larger firms. Due to the current economic climate, small and medium firms face the Hobson's choice of "betting it all" on a contract they may not get, or self-selecting out of the federal design-build market.

Unfortunately, federal law enables agencies to create ever-longing short lists. Under current law, agencies are required to short list between three and five teams. However, he law states that contracting officers have the flexibility to increase the number of finalists if increasing the number is "in the Federal Government's interest and is consistent with the purposes and objectives of the two-phase selection process." [10] This exception is so broad that agencies use it without given it a second thought.

Therefore, we ask the Committee to look at tightening the statute so that all firms can accurately determine the risks and rewards of participating in this market.

**One-Step vs. Two-Step Design Build**

Although many agencies employ the two-step design-build process outlined above, some agencies use a one-step design-build process. In a one-step process, agencies eliminate the pre-selection step and open the solicitation to all respondents. This allows for the government to review as many responses as they receive without reviewing the qualifications of the bidders prior to receiving a bid.

This concept sounds attractive, but when a contracting officer receives 30, 40, or 50 responses, this selection method becomes an inefficient use of limited federal government time and resources. Moreover, one-step selection allows for teams that do not have experience, effective past performance, or accurate bids to participate in the process. Contracting with teams that do not have the qualifications for the specialized work that is required on government projects frequently creates problems in the execution of the project. This leads to higher costs and longer delivery time which is not in

[8] Ibid at 9.
[9] Ibid at 12.
[10] 11 USC § 3309(d)

the best interest of the government. In addition, inexperienced or under-qualified teams could become legally obligated to fulfill contractual promises they simply cannot meet—or a mistake in a bid will cause them devastating liability.

That is why we respectfully ask that the Committee consider limiting the use of single-step design-build to projects that are less than $750,000. This threshold is based on U.S. Army Corps of Engineers guidance which was issued in August 2012. By limiting single step procurement to these projects, there will be less risk for teams who want to pursue this work, and it will allow for more small businesses to participate in the process. This limit allows smaller firms to gain valuable experience and exposure to the federal construction process, while also limiting federal agencies' burdens in reviewing a large number of proposals.

In conclusion, I would like to thank Chairman Hanna, Ranking Member Meng, and members of the Subcommittee for giving me the opportunity to testify before you today. The AIA commends you for your commitment to addressing the challenges that small businesses face in this economy and your leadership in advancing legislation that helps small businesses drive the recovery. The challenges that we as small businesspeople face are serious, but so is our commitment to play a leading role in rebuilding our country.

U.S. Women's Chamber of Commerce

# Testimony of
# Felicia James, President
# Primestar Construction

## Before the House Small Business Committee
## Subcommittee on Subcontracting & Workforce
## Thursday, May 23, 2013 at 10:00 a.m.
## Rayburn House Office Building, Room 2360

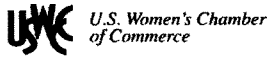
My name is Felicia James and I am the President of Primestar Construction. Primestar Construction is a Women Owned, 8 (a) and HubZone certified full service construction firm having executed and successfully completed several trades identified in various construction projects. I am a member of the U.S. Women's Chamber of Commerce and was recently appointed as an agency liaison to the U.S. Navy and Air Force. We are over a half a million member network of highly qualified viable women owed firms. I come to you today having preformed both as Sub-contractor, and General with major specialty industries self -performance capabilities; to elaborate on the support of the two step design build contracting vehicle, the reverse auction bidding, ability to acquire credit for tiers other than the 1st as it relates to the Sub-contracting small businesses.

### Primestar Construction supports the use of two step design build contracts.

Most design-build public projects today are procured via a two-step approach. First, requests for qualifications (RFQs) are sent to potential design-builders and design-build teams. Based on the responses to the RFQs, 3-5 design-builders are short-listed and are given a Request for Proposal (RFP) seeking competitive submittals, the winner of the process being awarded the design-build contract.

Unfortunately, due in part to the competition with large construction firms, many Small businesses are not selected for inclusion among the qualifying offerors for the second phase. For a small business to be successful in the two step design build process, there needs to be a percent allocation reserved for Small businesses like Women-owned or other small business set-aside within the second phase contractor pool. This would allow an opportunity for the selection committee to continue to evaluate the potential team and help Small businesses procure construction project in the two step design build process.

Primestar and other women-owned businesses with similar structures can continue to compete with the assurance that we will make it to a level beyond submission to attain award.




**Primestar Construction stands in strong opposition to the use of reverse auction for construction projects.**

Reverse auctions were originally designed to procure commodities and other manufactured goods. This procurement method should not be used for the following reasons:

- Reverse auctions don't necessarily guarantee the lowest bid
- Set aside programs are non-existent and could potentially violate federal procurement laws, particularly the simplified acquisition thresholds which helps small businesses.
- Small businesses are unable to afford the additional costs of website, membership & software needed to use Reverse Auctions.
- Small businesses are often unable to compete with the incumbent (typically large prime) who has multiple awards and can afford to reduce pricing.

Overall, the impact this procurement has on Primestar would be a cost to my bottom line, having to wade through an additional qualification criteria beyond that of the federal requirements needed for the various set-aside designations.

**Primestar Construction does not believe that prime contractors should receive credit for Small businesses used as second and third tier subcontractors.**

Prime Contractors should be credited only to the first tier subcontractors. Changing the credit process to include second and third tier contracts will encourage bundling of projects into larger portions, diminish the amount of first tier sub-contractor awards to Small businesses and make it harder for Small businesses to access larger portions of federal projects thereby making it harder for Small businesses to grow and become more competitive in the federal marketplace.

- Including all the tiers into the sub-contracting plan would lower the number of first tier sub-contractor awards to Small businesses that desperately need and are qualified to perform the work.

- The current system allows for mentor/protégé relationships that will enhance my firm's capability to more successfully compete for larger projects.

  I am currently in discussions now with several large construction companies that will provide my construction firm opportunities for growth that might not be available if the current small business first tier contractor system wasn't in place. The revenue and qualifications are sometimes diminished as the tiers levels dissipate. Some companies at this level are given opportunities that may not be afforded them not with a large business. As with the U.S. Women's Chamber of Commerce, we have a network that can be a resource of Small businesses at various levels that are given opportunities to preform and grow because another small business assigned work at a lower tier and assumed liability, thus help the growth of that business.

  I am extremely concerned and fear that if the tiered system was changed then the change will dilute the leverage of the small business entity within the mentor/protégé program and their participation in the completion of larger construction projects would be significantly reduced.

The benefit of a large firm entering into a mentor/protégé relationship with a small construction firm like mine is viable because the large firm would utilize the benefits of my 8a, Small, Hub-Zone and ED-WOSB certifications and be able to provide services and subsequently profit from this project, which due to their size, the large firm I partner with normally wouldn't be able to compete or provide a bid.

- Including second tier and third tier sub-contractors in the subcontracting plan would violate the intended purpose of the Small Business Program, which is "to maintain and strengthen the nation's economy by enabling the establishment and viability of small businesses."

## Primestar supports H.R. 776, the Security in Bonding Act of 2013.

The bill adds transparency to the surety assets. By increasing the guarantee to 90%, more small and emerging businesses like myself will have more opportunities to participate in the SBA's Surety Bond Guarantee Program. The provision to increase to $6.5 million from $2 million the amount the SBA will guarantee should help make bonds available to more small and minority contractors. Being able to see clearly the asset backing a bond will allow contractors and federal contracting officers to know the guarantees promised on paper are backed by honest companies pledging real assets.

In conclusion, thank you for the opportunity to provide my testimony to you today.

- **Primestar Construction supports the use of two step design build contracts**
- **Primestar Construction stands in strong opposition to the use of reverse auction for construction projects**
- **Primestar Construction does not believe that prime contractors should receive credit for Small businesses used as second and third tier subcontractors**
- **Primestar supports H.R. 776, the Security in Bonding Act of 2013**

The SBA needs to continue to calculate small business participation for first tier contractors as it currently exists. Changing the system to include second and third tier contractors would irreparably harm the women owned, emerging and small businesses the program was put in place to assist.

**RECORD VERSION**

**STATEMENT BY**

**JAMES C. DALTON, P.E.**

**CHIEF, ENGINEERING AND CONSTRUCTION**

**U.S. ARMY CORPS OF ENGINEERS**

**BEFORE THE**

**COMMITTEE ON SMALL BUSINESS**

**SUBCOMMITTEE ON CONTRACTING AND WORKFORCE**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**FIRST SESSION, 113TH CONGRESS**

# ON THE CORPS' POLICIES REGARDING TWO-STEP DESIGN BUILD CONTRACTS, THE USE OF REVERSE AUCTIONS FOR CONSTRUCTION, CORPS' EXPERIENCE WITH ACCEPTING SURETY BONDS PROVIDED BY NON-CORPORATE SURETIES, AND WHETHER ALLOWING THE PRIME CONTRACTOR TO RECEIVE CREDIT FOR LOWER TIERED SUBCONTRACTORS WILL IMPROVE THE USE OF SMALL BUSINESSES

**May 23, 2013**

**NOT FOR PUBLICATION UNTIL RELEASED BY THE COMMITTEE ON SMALL BUSINESS**

Mr. Chairman and Members of the Subcommittee, I am James Dalton, Chief of Engineering and Construction for the U.S. Army Corps of Engineers (Corps). I provide engineering and construction leadership to nine divisions, 45 districts, and guide the development of engineering and construction policy for our world-wide Civil Works and Military Programs missions. Thank you for the opportunity to testify today to discuss construction contracting and improved small business participation.

The Corps fully recognizes the value that small businesses bring to our national economy, and is committed to using small businesses in performing our work. We use Small, Small-Disadvantaged, Women-Owned, HUBZone, Veteran-Owned, and Service-Disabled Veteran Owned firms to the maximum extent possible, and typically, each year the Corps of Engineers awards over 40 percent of its prime contract dollars to small businesses.

My testimony will address the Corps policies regarding two-step design build contracts, the use of reverse auctions for construction, Corps experience with accepting surety bonds provided by non-corporate sureties and whether allowing the prime contractor to receive credit for lower tiered subcontractors will improve the use of small businesses.

## Use of Two-Step Design-Build Contracts

The Corps employs various acquisition strategies and contract types to perform its mission whether the effort is for construction, engineering, environmental services, or operation and maintenance of facilities. During the last ten years the Design-Build project delivery system has been used for many of the Corps' construction requirements. The Federal Acquisition Regulation (FAR) Part 36.102 definition of Design-Build is the combination of design and construction in a single contract with one contractor responsible for the design and construction. The FAR further defines Two-Phase Design-Build, also known as Two-Step Design Build, as a source selection procedure in which a limited number of offerors (normally five or fewer) are selected during Phase One to submit detailed proposals for Phase Two. The Corps utilizes the Two-Phase Design-Build process and has developed policy implementing the Federal Acquisition Regulation. The Corps also utilizes a One-Step Design-Build for Turn-Key process as authorized by Statute 10 USC 2862. The Corps policy discourages the use of One-Step Design Build procedures for most construction requirements.

The Two-Phase selection procedure allows offerors to submit (relatively inexpensively) information related to experience and past performance in step one. Based on this information, the source selection authority selects a limited number of the most qualified offerors to advance to Phase Two of the competition, where the down-selected offerors (generally three to five) submit much more resource intensive price and technical proposals for evaluation. The offerors advancing to Phase Two have a much more favorable chance of winning the competition and are therefore incentivized to

submit superior technical and price proposals, which reduces overall costs to the government and industry.

### Use of Reverse Auctions for Construction

The Corps conducted a pilot program to evaluate the use of reverse auctioning at eight separate Corps Districts (Louisville, Ft. Worth, Norfolk, Omaha, Philadelphia, Savannah, Huntsville Center, and Pittsburgh). Contracting Officers used the reverse auction process on nine individual projects for construction (5), commodities (3), and supplies and services (1). The Corps received protests on two of the construction projects and one of the protests was sustained due to a problem with the software used to implement the auction.

A reverse auction is conducted utilizing an online tool where buyers can procure commodity-type commercial items or services and satisfy competition, publicizing, and reporting requirements as part of the process. A vendor cannot view the name of other vendors during the bidding period, but knows the relative position of its price to those of its competitors and sometimes may be able to view the prices of other competitors. A vendor can reduce its bid and underbid another vendor until the bidding period closes.

Vendors may be allowed to ask questions directly to the contracting officer during the bidding period and in that event the system allows the contracting officer to respond directly to the vendor that submitted the question. Vendors can only view other vendor's questions and answers if these questions and answers are posted as an attachment to the RFQ.

The Corps, through its pilot study, found no basis to determine that reverse auctioning provided any significant or marginal savings over a traditional contracting process for construction. Reverse auctioning provides benefit when the commodities or manufactured goods procured are of a controlled and consistent nature with little or no variability. Construction is not a commodity and is more closely related to a professional service. Procuring construction by reverse auction neither ensures a fair and reasonable price nor selection of the most qualified contractor.

Our most recent experience with contracting using reverse auctions was in 2008 when the Corps solicited for clay borrow material in New Orleans. Using reverse auctions was intended to expedite the contracting process and ultimate delivery of the project. The outcome was poor as the contractor was unable to perform to the contract requirements and the contract was partially terminated for convenience. The requirement had to be reprocured using traditional construction contracting procedures where the prime construction contractors were responsible for the procurement of clay borrow materials. This experience did not reflect poorly on the reverse auction process itself, but rather on the scope of services procured. The scope of services required the delivery of a construction material (clay borrow material) to multiple construction sites for use by multiple prime construction contractors in the construction

of embankment levees. The coordination efforts proved to be more difficult than anticipated by either the Corps or the material supplier.

### Surety Bonds Provided by Non-Corporate Sureties

Pursuant to the Miller Act as implemented by Regulation, before a construction contractor is allowed to start work on a contract of more than $150,000, it generally must furnish performance and payment bonds. A performance bond with a surety satisfactory to the contracting officer is required in an amount the contracting officer considers adequate for the protection of the Government. Generally, the penal amount—the penalty the principal could incur—of the bond is 100 percent of the contract price. A payment bond is also required for the protection of all persons supplying labor and material. The amount of the payment bond is the same as the amount of the performance bond. If the surety does not have the ability to pay in the event the contractor cannot perform, the project and the suppliers and subcontractors are put at risk.

For contracts exceeding $30,000 but not exceeding $150,000, alternative payment protection (e.g. irrevocable letter of credit) may be provided in the amount of the contract price.

The Corps complies with the Miller Act as implemented by the FAR. Performance and Payment Bonds are required on the vast majority of all construction requirements in excess of $150,000 prior to the issuance of a Notice to Proceed.

Sureties make money through volume, not by taking risks. Solid relationships with sureties and brokers remain the key to any construction companies attempting to obtain bonds.

Approximately two thirds of the surety market is effectively controlled by fewer than a dozen companies (fewer for environmental contracting). This limited presence of market providers present small companies with financial challenges, such as bonding availability, pricing and risk evaluation. Smaller companies are more vulnerable than large companies as a result of this industry concentration.

The FAR does contemplate the use of non-corporate sureties, but this option presents its own set of unique challenges. For example, a non-corporate surety must be creditworthy, and present acceptable security to support its promise to step into the contractor's shoes, so to speak, to perform the work contracted for by the Government and to pay any subcontractors in accordance with the terms of the performance and payment bonds the surety has presented to the Government.

In accordance with the FAR, the Corps gives full consideration to the acceptability of non-corporate sureties, referred to in the FAR as individual sureties. The Corps does not collect data regarding the frequency with which non-corporate sureties are proposed or accepted. Generally, non-corporate sureties are proposed much less frequently than corporate sureties. The use of non-corporate sureties requires the expenditure of Government resources to in-

vestigate the acceptability of pledged assets. In our experience, proposals to use non-corporate sureties are generally rejected by the contracting officer for two basic deficiencies: either the claimed value of the pledged asset cannot be established, or the asset's ownership may be in question. The Corps will not accept sureties that do not meet the requirements of the FAR and that present an unacceptable risk to the Government.

**Prime Contractor Small Business Credit for Lower Tiered Subcontractors**

Present regulations allow only the prime contractor to report the dollars it awards directly to its subcontractors. However, regulations also require a subcontractor to report the dollars it awards directly to its subcontractors. So in effect, subcontracting dollars are being reported from the prime contractor and subcontractors regardless of their tier-level under the prime contract.

The Corps requires small business subcontracting plans in negotiated acquisitions for construction contracts, which are expected to exceed $1.5M and have subcontracting possibilities (FAR 19.702). The Corps also requires each large business contractor with such type contract to also require the same for their large business subcontractors. The subcontractors are required to do the same to their subcontractors. As a result, a contract with a subcontracting plan requires the prime to flow-down the same requirement to its subcontractors, and for its subcontractors to do the same to their subcontractors.

A subcontracting plan is contract specific to a contract and requires the contractor to provide goals ($ and %) it plans to subcontract to small business, small disadvantaged business, HUBZone business, women-owned small business, veteran-owned small business and service-disabled small business. The subcontracting plan also requires the contractor (prime and subcontractor) to report annually the dollars they award to their subcontractors. The reporting is accomplished via the federal Electronic Subcontracting Reporting System (eSRS). As a result, subcontracting can be determined cumulatively for a contract. This represents the subcontracting dollars reported by the prime contractor and all of the lower-tier contractors under the same prime contract. However, eSRS has some limitations; as a result, determining the subcontracting achievements for a department/agency/organization is difficult based on the contracts they award. Nonetheless, these issues are being addressed between the Department, GSA (system manager) and SBA.

Allowing prime contractors to count all reported activity towards their goals would require a change to the processes for negotiating subcontracting goals, a change in the systems to collect the data and change in the method accounting for subcontracting activity across the entire Federal Government. Although these changes would still not guarantee improvement in subcontracting opportunities for small businesses, they would provide better data to manage subcontracting. It is unknown if allowing large primes to claim

credit for small businesses used by their second and third tier subcontractors would lead to improved usage of small business firms on Corps contracts.

Mr. Chairman, this concludes my statement. Thank you again for allowing me to be here today to discuss the Corps small business construction contracting. I would be happy to answer any questions you or other Members may have.

U.S. SMALL BUSINESS ADMINISTRATION

WASHINGTON, D.C. 20416

**TESTIMONY OF**

**JEANNE A. HULIT**

**ASSOCIATE ADMINISTRATOR**

**OFFICE OF CAPITAL ACCESS**

**U.S. SMALL BUSINESS ADMINISTRATION**

**BEFORE THE**

**SUBCOMMITTEE ON CONTRACTING AND WORKFORCE**

**HOUSE COMMITTEE ON SMALL BUSINESS**

**U.S. HOUSE OF REPRESENTATIVES**

**MAY 23, 2013**

Thank you Chairman Hanna, Ranking Member Meng and members of the Subcommittee. I am pleased to testify before you today on the topic of surety bonds.

The Small Business Administration (SBA) Surety Bond Guarantee Program was established in 1971 to help small businesses obtain the surety bonds that are often required as a condition of awarding a construction contract or subcontract. For example, the Federal government requires a surety bond on any construction contract valued at $150,000 or more. Most state and local organizations have similar bonding requirements, as do many private construction projects.

The Small Business Administration (SBA) Surety Bond Guarantee Program was established in 1971 to help small businesses obtain the surety bonds that are often required as a condition of awarding a construction contract or subcontract. For example, the Federal government requires a surety bond on any construction contract valued at $150,000 or more. Most state and local organizations have similar bonding requirements, as do many private construction projects.

SBA's program helps small and emerging firms become bonded by guaranteeing a portion of the bond issued by a participating surety company. The SBA guarantee acts as an incentive for surety companies to bond eligible small businesses that might not otherwise fit traditional surety bonding criteria.

There are two types of SBA surety bond guarantees: (1) those made through our Prior Approval Program, which provide an 80% or 90% guarantee (depending on the size of the contract and the type of small business); and (2) those made under SBA's Preferred Program, which provide a 70% guarantee. There are 21 surety companies participating in SBA's program—17 in the Prior Approval Program and 4 in the Preferred Program. Currently, about 86% of our bonds are issued through the Prior Approval Program, while about 14% are made through the Preferred Program.

I am pleased to report that Fiscal Year 2013 is on track to be the seventh consecutive year of program growth. To date, we have issued 7,595 bond guarantees representing contracts valued at over $3.5 billion. This is approximately 49% ahead of last year's volume in terms of the number of bond guarantees issued, and about 65% ahead of last year's numbers in terms of total contract value.

SBA values its partnership with the surety industry and knows that it is fundamental to the program's success. We continue to refine our processes and procedures to strengthen this partnership. We are currently completing work on regulatory changes that address several industry concerns while simplifying and clarifying processes for our surety partners.

In August, we implemented a new Quick Bond Guarantee Application—known as Quick App—for contracts valued at $250,000 or less. This streamlined process adopts an industry "best practice" by eliminating much of the paperwork on small contracts without increasing performance risk. So far this year, Quick App accounts for approximately 19% of eligible applications. And since implementation, over 685 Quick Bond guarantees have been issued. Based on our experience over the past eight months, as well as feedback from our surety partners, we are further refining the Quick App process and expect its use to increase substantially during FY 14.

In terms of legislative changes within our program, the National Defense Authorization Act of 2013 raised the individual contract ceiling in the program from $2 million to $6.5 million. The new law also permits bonding of Federal contracts up to $10 million where the contracting officer certifies that an SBA surety bond guarantee is in the best interest of the government. Additionally, the Defense Authorization Act provides SBA with broader discretion when it assesses bond liability.

These changes have been well received across the surety industry and among small businesses. So far, we have issued 97 bond guarantees on contracts valued at $2 million or more. This represents approximately $290 million in new construction contracts. In addition, we have seen the number of participating surety agents increase by 15%, and we have admitted two new surety companies to the program in just the past few months.

With respect to key program performance measures, the average contract default rate over the past five years is approximately 3%. It is noteworthy that we have not seen any defaults on the larger contracts authorized under the Defense Authorization Act, and we have had zero defaults on Quick App contracts. Additionally, the

Program has experienced a positive cash flow in each of the past six years.

The SBA Surety Bond Guarantee Program is helping the small business community grow and prosper during a critical time in our nation's economic recovery. We look forward to working closely with you and your staff on any changes to the program, as well as other SBA initiatives that support small and emerging firms.

I appreciate the opportunity to testify before you today, and I welcome any questions you may have.

Thank you.

# Default Rate

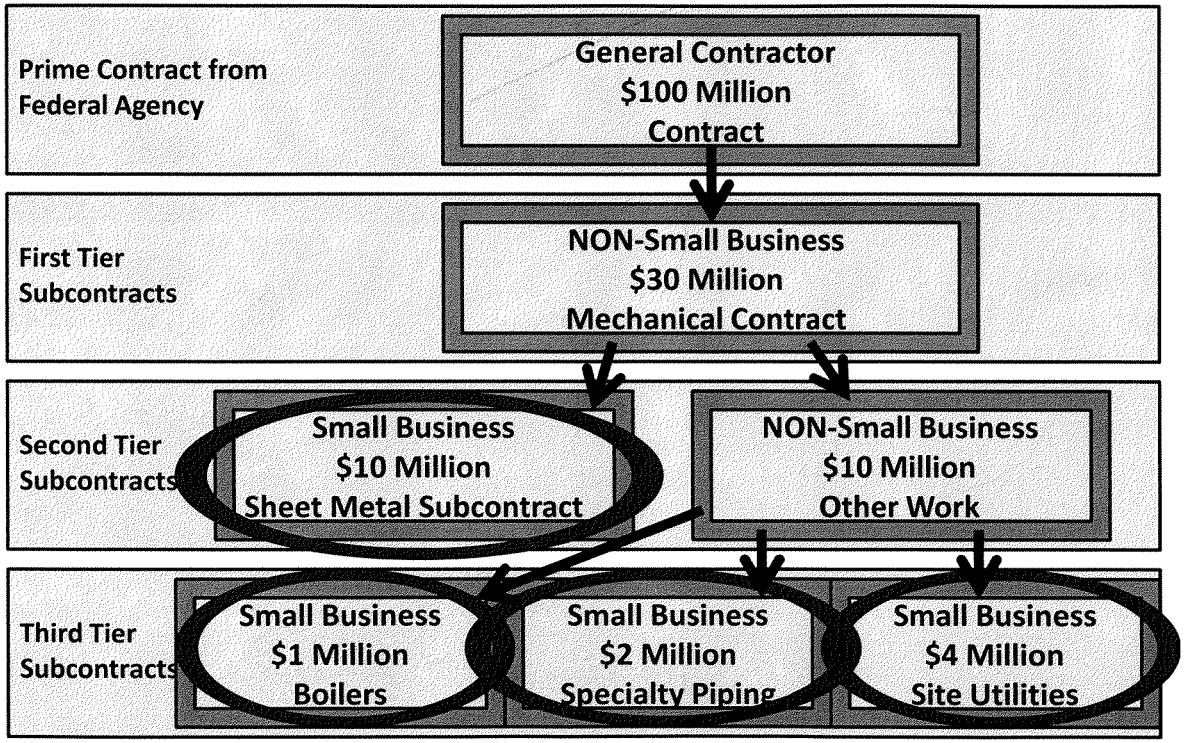
| Default Rate | FY '08 | FY '09 | FY '10 | FY '11 | FY '12 |
|---|---|---|---|---|---|
| **Prior Approval** | 2.23% | 2.96% | 4.90% | 4.08% | 2.58% |
| **PSB** | 3.72% | 5.41% | .58% | 2.71% | 4.79% |
| **Total** | 2.56% | 3.49% | 3.95% | 3.78% | 3.06% |



| | Mean Default Rate |
|---|---|
| **Prior Approval** | 3.32% |
| **PSB** | 3.44% |
| **Total** | 3.35% |

Current Law

# TRANSPARENCY: DETERMINING TRUE SMALL BUSINESS PARTICIPATION



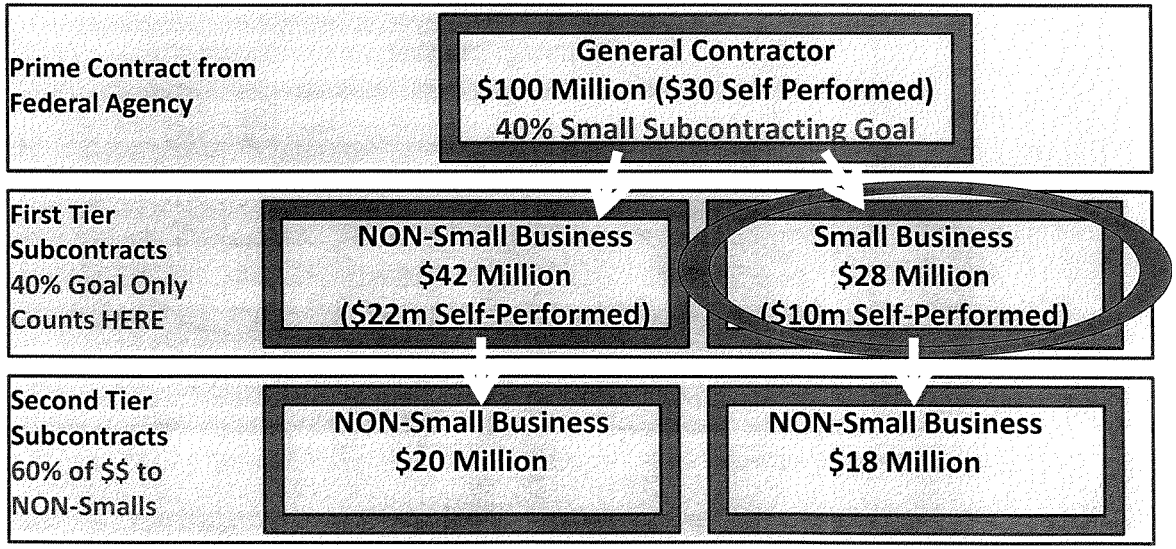
Current Law

# GROWTH: PROVIDING FOR MORE SMALL BUSINESS PARTICIPATION

-General Contractor Goaled on Maximum Practicable Utilization of Small Business at ONLY 1st Tier

-NO Incentive to Drive Small Business $$ Below 1st Tier

-Majority of Funds May NOT go to Small Businesses



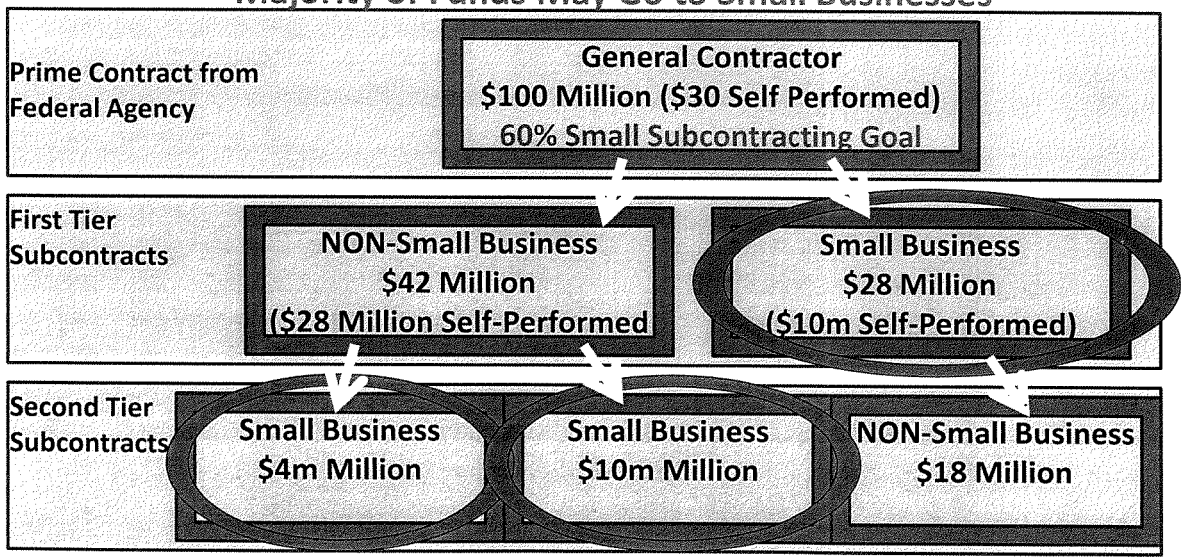
REFORM

# GROWTH: PROVIDING FOR MORE SMALL BUSINESS PARTICIPATION

-General Contractor Goaled on Maximum Practicable Utilization of Small Business at LOWER Tiers

-Incentive to Drive Small Business $$ Below 1st Tier

-Majority of Funds May Go to Small Businesses



# Statement for the Record

**Hearing**
**on**
**Building America:**
**Challenges for Small Construction Contractors**

**May 23, 2013**

**before**

**Subcommittee on Contracting and Workforce**
**Committee on Small Business**
**U.S. House of Representatives**

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Chairman Hanna, Ranking Member Meng, and Members of the Subcommittee, the **American Subcontractors Association, Inc.** (ASA) expresses its thanks for your clear commitment to assuring small business participation on Federal Government construction procurement. We ask that this statement be included in the hearing record.

ASA is a national trade association representing subcontractors, specialty trade contractors, and suppliers in the construction industry. ASA members work in virtually all of the construction trades and on virtually every type of horizontal and vertical construction. ASA members frequently contract directly with the Federal Government. More often, they serve as subcontractors dealing with the Federal Government through a prime contractor. More than 60 percent of ASA members are small businesses.

Construction contractors and subcontractors face numerous obstacles to participating on Federal projects. Two of the biggest obstacles are the bidding/proposal process itself, and, getting paid promptly for work properly performed. To address these obstacles, ASA recommends that Congress:

- Deter bid shopping and bid peddling by prohibiting the use of reverse auctions for construction and construction-related services at both the prime and subcontract levels.
- Deter bid shopping at the subcontract level by requiring the prime contractor to submit with its bid, a list of the subcontractors it intends to use.
- Encourage small business participation on design-build contracts by requiring the use of the two-step method for the procurement on all but the smallest contracts.
- Increase access to surety bonds by small firms by increasing to 90 percent the guarantee available to sureties under the SBA Surety Bond Guarantee Program.
- Assure subcontractor and supplier payment by applying to individual sureties the same standards currently applied to corporate sureties.
- Assure subcontractor and supplier payment on the construction components of projects financed by public-private partnerships by requiring surety bonds on such contracts.
- Assure payment to the smallest of subcontractors and suppliers by exempting the Miller Act from periodic inflation adjustments.

**Prohibit Reverse Auctions**

A reverse auction essentially is an online, real-time dynamic auction between a buying entity (e.g., owner, contractor) and pre-qualified vendors who compete against each other to win a contract. These vendors compete by bidding against other, usually over the Internet, by submitting successively lower-priced bids during a specified bid period, usually about one hour.

Electronic reverse auctions have brought ever greater efficiency to the abhorrent practice of "bid shopping" in the construction industry. Bid shopping occurs when an owner or prime contractor di-

vulges the general contractor's or subcontractor's bid to secure a lower bid from a competitor. According to a joint statement issued by the Associated General Contractors of America, ASA, and the Associated Specialty Contractors:

> "Bid shopping and bid peddling are abhorrent business practices that threaten the integrity of the competitive bidding system that serves the construction industry and the economy so well."

ASA concurs with AGC, in its May 23 statement to the Subcommittee:

> "Reverse auctions create an environment in which bid discipline is critical yet difficult to maintain. The competitors have to deal with multiple rounds of bidding, all in quick succession. The process may move too quickly for competitors to accurately reassess either their costs or the way they would actually do the work. If competitors act rashly and bid imprudently, the results may be detrimental to everyone, including the owner. Imprudent bidding may lead to performance and financial problems for owners and successful bidders, which may have the effect of increasing the ultimate cost of construction as well as the cost of operating and maintaining the structure."

The same problems arise when a prime contractor uses a reverse action to obtain bids from subcontractors.

Thus, ASA supports legislation prohibiting reverse auction procurement for construction and construction-related services at both the prime contractor and subcontractor levels.

**Require Subcontractor Bid Listing**

ASA also supports the implementation of a requirement that a prime construction contractor on a low-bid solicitation for construction and construction-related services submit with its bid a list of the subcontractors it intends to use if it is awarded the contract.

On those contracts for which the Federal Government relies on a procurement system in which the lowest responsible and responsible bidder prevails, the cost to the Government is firmly established on the date of contract award. Should the successful prime contractor subsequently be able to reduce its cost of performance by persuading prospective subcontractors to submit ever lower bids—either slowly through individual telephone calls or quickly with an electronic reverse auction—the prime contractor alone reaps the cost savings. ASA believes that allowing a prime contractor to bid shop after it has been awarded a contract by the Government potentially leads to a lower quality of work, materials and equipment for the Federal customer. Further, the risk of prime contractor bid shopping deters the most qualified subcontractors from ever competing for such contracts.

Thus, ASA strongly supports legislation, such as H.R. 1942, the "Construction Quality Assurance Act of 2013," which would require subcontractor bid listing on Federal construction projects exceeding $1 million procured through sealed bids. Essentially, subcontractor bid listing requires a prime contractor to submit a list of the sub-

contractors it intends to use on the Government project along with its bid. *Subcontractor bid listing is, perhaps, the strongest deterrent to the "abhorrent" practices of bid shopping and bid peddling at the subcontract level.*

Subcontractor bid listing also will serve to further several other goals of the Federal Government. First, subcontractor listing will help protect homeland security by assuring that the Government knows in advance what firms are actually working on its projects, Second, subcontractor listing will help the Government better encourage and monitor the use of small and other historically underutilized businesses on its contracts, *before* the prime contractor awards subcontracts to other firms.

ASA notes that the Congress already enacted, as part of the Small Business Jobs Act of 2010 (Pub. L. 111–240), a requirement that a large business prime contractor must represent that it will make a good faith effort to award subcontracts at the same percentage as indicated in the subcontracting plan submitted as part of its proposal for a contract and that if the percentage is not met, the large business primate contractor must provide a written justification and explanation to the contracting officer. Unfortunately, the U.S. Small Business Administration has still not implemented that statutory requirement, even though it issued a Notice of Proposed Rulemaking in Oct. 2011 (RIN 3245–AG22). That proposed rule would require a prime contractor awarded a Federal construction contract valued at more than $1.5 million to "notify the contracting officer in writing whenever the prime contractor does not utilize a subcontractor used in preparing its bid or proposal during contract performance." ASA asks that the Committee direct SBA to expeditiously issue and implement a final rule.

**Encourage Two-Step Procurement for Design-Build Contracts**

ASA joins other construction associations in urging the Congress to use the two-step method of procurement for most design-build projects. By assuring that there is a first qualification step for such projects, before a design-builder or design/contractor team must submit a full proposal, the Government will help assure that smaller firms can afford to participate in its procurement process.

**Enhance the SBA Surety Bond Guarantee Program**

ASA remains a strong supporter of the programs operated by the Small Business Administration (SBA) to facilitate access to surety bonds issued by corporate sureties that have been vetted and approved by the Department of the Treasury. SBA's Surety Bond Guarantee Program has helped many small business concerns to obtain the surety bonds that they needed to compete for Federal prime contract opportunities in construction. ASA was a major participant in the coalition that supported the legislation sponsored by former Senator Sam Nunn of Georgia that provided a statutory basis for the SBA's Preferred Surety Bond Guarantee Program. The Preferred Surety Bond Guarantee Program broadened the pool of corporate sureties willing to participate in the SBA Program assist-

ing yet additional numbers of small business concerns. SBA has made marked strides to improve the application process for surety bonds provided under the Program. However, ASA believes that the Program could be further improved by enactment of Section 3 of H.R. 776, the "Security in Bonding Act," which would increase to 90 percent the guarantee offered to participating sureties.

**Require Individual Sureties to Meet the Same Standards as Corporate Sureties**

One of the principal obstacles to small business participation on Federal Government procurement is the concern that payment for work performed will not be forthcoming. On a typical construction project, subcontractors extend a significant amount of credit to their prime contractor clients. Thus, the American dream of winning a federal contract can quickly turn into an American nightmare if payment is not timely received. ASA strongly supports H.R. 776, the "Security in Bonding Act," which is designed to deter those individual sureties who succumb to the temptation to misrepresent the assets being pledged in support of the surety bonds that they are furnishing.

Since the 1980's, ASA has participated actively in the various regulatory efforts to assure that the payment bonds furnished by individual sureties actually provide the real payment protections for subcontractors and suppliers intended by the statutory mandate of the Miller Act. The use, and abuse, of individual sureties have tended to be episodic in nature. Unfortunately, the construction industry, and especially small subcontractors and suppliers, are currently facing another sustained episode. The potential for inadequate or worthless payment bonds to be furnished by individual sureties has been exacerbated by the advent of increasingly convoluted forms of financial instruments and the sustained overload of responsibilities that currently are being required of a deeply understaffed corps of Federal contracting officers and supporting acquisition professionals.

The current coverage of the Government-wide Federal Acquisition Regulation (FAR) Subpart 28.2 (Sureties and Other Security for Bonds) provides the contracting officer very solid guidance, but implementation can be compromised by severe challenges, especially if the individual surety is determined and skilled in gaming the system. The core challenge for the contracting officer relates to assessing the assets being pledged by the individual surety in support of the surety bonds being furnished to the Government. Do the assets being pledged actually exist? What is the real value of the pledged assets? Can the pledged asset, although real and properly valued, be readily liquidated? Claims against a payment bond under the Miller Act are generally paid in cash, not, for example, timber "available" to be harvested for milling.

By training and experience, even the most seasoned contracting officer in the acquisition of construction is likely at a distinct disadvantage in making these determinations with regard to the broad array of assets acceptable under FAR Part 28.203–2. The challenge is presented not only with regard to real property and

raw commodities, often in locations remote from the contracting officer's location, but also by increasingly opaque forms of "secure" financial instruments. The determined individual surety has the ability to mount a focused and lengthy effort to get the contracting officer to accept the proffered assets. Today, the typical contracting officer has too many contract award and contract administration actions on-going simultaneously and too few supporting staff resources. To get forward motion on the award of a particular construction contract for the benefit of the ultimate Federal user, the contracting officer may be willing to acquiesce, especially if the exposure to the Government is relatively small due to the small likely contract award value of the contract, especially in this era of contracts valued in hundreds of millions of dollars, if not billions. A payment bond from an individual surety providing only illusory protection can, however, easily result in a catastrophic loss to a small subcontractor or supplier on the "small" contract.

Given the Government's responsibility as steward of the taxpayers' money, as well as the practical limitations of the current FAR-based system for the protection of subcontractors and suppliers, ASA believes that Congress needs to enact remedial legislation to deter those individual sureties who succumb to the temptation to misrepresent the assets being pledged in support of the surety bonds that they are furnishing.

H.R. 776, the "Security in Bonding Act," is such a targeted Congressional intervention. It simply applies to individual sureties the same standards currently permitted by the Miller Act (31 U.S.C. 9303) for a prime contractor choosing to furnish "eligible obligations" rather than a surety bond. When H.R. 776 becomes law, Federal contracting officers will be able to have certainty that the assets pledged by an individual surety are real, sufficient in amount, and readily available should any payment claims arise. For ASA, construction subcontractors and suppliers will be able to have confidence that the bonds furnished by the individual surety will provide the payment protection of last resort intended by the Miller Act.

**Require Surety Bonds on Public-Private Partnerships (P3)**

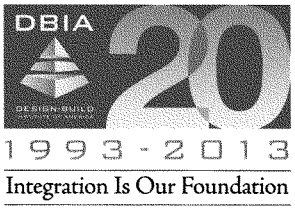
ASA strongly urges Congress to take steps to assure that contracts with construction components financed by public-private partnerships (P3) that include Federal support, provide payment protections to subcontractors and suppliers at least as effective as those provided by the Miller Act on construction undertaken directly by a Federal agency or by the so-called Little Miller Acts of the various States for construction projects undertaken by a state agency. The reality of construction contracting, whether public or private, has been for many, many years that subcontractors do the vast preponderance of the work. The use of a P3 does not change this practical reality. The successful undertaking and timely completion of a P3, with substantial contributions of public resources, including Federal assets or financial support, will require that construction subcontractors and suppliers be fully and timely paid, in accordance with the contract, for work performed.

Given the unpredictable diversity of public-private partnerships, subcontractors and suppliers too frequently encounter a dangerous void in essential payment protections for work performed. The severe risk inherent in the absence of reliable payment protection can only reasonably be expected to increase costs for the overall construction project being undertaken through the public-private partnership as subcontractors and suppliers seek to accommodate the increased risk or even completely deter bidding by the most skilled subcontractors and suppliers, whose resources can be directed at projects in which solid payment protections are available.

**Exempt the Miller Act from Inflation Adjustments**

Finally, ASA urges the Congress to add the Miller Act to procurement thresholds exempted from the periodic inflation adjustments required by 41 U.S.C. Sec. 431. In 2010, the Federal Acquisition Regulatory Council increased the threshold for payment security for subcontractors and suppliers on Federal construction contracts from $100,000 to $150,000, thus leaving many more small business subcontractors and suppliers exposed to the risk of non-payment. Each additional increase in the threshold will expose even more small business subcontractors and suppliers to non-payment for work performed.

Chairman Hanna, thank you for so promptly scheduling this legislative hearing. ASA urges equally prompt, and favorable, action by the Full Committee on Small Business, under the leadership of Chairman Graves.




Statement of

**THE DESIGN-BUILD INSTITUTE OF AMERICA**

Regarding

Building America: Challenges for Small Construction Contractors

Before the

Subcommittee on Contracting and Workforce
Committee on Small Business
U.S. House of Representatives
2360 Rayburn House Office Building

May 23, 2013

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Washington, D.C. 20003-1718
202-682-0110
www.dbia.org

## INTRODUCTION

Chairman Hanna, Ranking Member Meng, and members of the committee, thank you for holding this hearing examining barriers to the maximum practicable utilization of small business construction and architecture and engineering contractors. Further, thank you for the opportunity for the Design-Build Institute of America to submit this testimony.

The Design-Build Institute of America (DBIA) is an institute of leaders in the design and construction industry utilizing design-build and integrated project delivery methods to achieve high performance projects. DBIA promotes the value of design-build project delivery and teaches the effective integration of design and construction services to ensure success for owners and design and construction practitioners.

## DESIGN-BUILD

Design-build is an integrated approach that delivers design and construction services under one contract with a single point of responsibility. Owners select design-build to achieve best value while meeting schedule, cost and quality goals. Best value ensures competitive proposals from industry that considers many factors as opposed to simply awarding contracts to the cheapest offer.

Design-build provides benefits for both owners and practitioners. Owners experience faster delivery, cost savings and better quality than other contracting methods. Dealing with a single entity decreases owners' administrative burden and allows them to focus on the project, rather than managing separate contracts. The approach also reduces their risk and results in fewer delays, disputes, claims and subsequent litigation for all parties involved.

Practitioners reap benefits since an integrated team is fully and equally committed to controlling costs. Like owners, the design-builder benefits from a decreased administrative burden because the communication between designers and builders is streamlined.

When DBIA was founded 20 years ago design-build authority for government agencies and municipalities was very limited. In fact, at the state level design-build authority for government projects was only authorized in two states. Today, design build is permitted in every state in some fashion, and the number of projects has doubled in the last five years. We've had similar success at the federal level with many key agencies using design-build in more than 75% of their projects, including the Army Corps of Engineers, State Department, Navy Facilitates Engineering Command, and Bureau of Prisons.

## DESIGN-BUILD DONE RIGHT: QUALIFICATIONS BASED SELECTION (QBS)

DBIA supports *Qualifications Based Selection* as a highly effective way of procuring a design-build services and ensuring project success, and encourages Congress to approve *Design-Build QBS* for all federal projects.

QBS is a method of selecting a design-build team for a given project in which the final criteria for selection are qualifications and demonstrated competence. price and cost are important factors, but under QBS they are considered when they should be, during contract negotiations, not during design-build team selection. Under QBS, the focus of the project and the entire team is on quality and value. It rewards teamwork, innovation, and proactive problem solving and ultimately the tax-payer is the winner.

In other words, QBS provides a competitive environment where offerors must compete on quality, past performance, schedule, experience, etc., and not just "low bid". Successful design-builders must be "good" and provide a competitive price to the government.

QBS exists in federal law today, also known as the Brooks Act (Public Law 92–582), but is limited to the selection of architects and engineers for federal projects. Further, full Design-Build QBS authority exists in three states, Florida, Arizona and Colorado, and several more have the authority in some way. QBS has proven to be a success on the state and federal levels, is strongly supported by architects and engineers who operate under it, and should be expanded to include design-build teams.

DBIA is actively supporting federal Design-Build QBS legislation. We will have draft legislation during this Congress, and look forward to working with the members of this committee on its passage.

**DESIGN-BUILD DONE RIGHT: BEST VALUE SELECTION (BVS)**

**Single-Step vs. Two-Step**

Federal regulation allows for the use of design-build project delivery, including both a single-step process and a two-step process. In the single-step process a request for proposals (RFP) is issued for a project. It is issued to an unlimited number of participants and any and all parties can respond with a proposal. A selection process is then used to determine the proposal that is best from both a cost and technical perspective.

In a two-step process a request for *qualifications* (RFQ) is issued first, and any and all participants then respond with a statement of qualifications. The RFQ response is a simple and inexpensive procedure where the design-build teams submit documents detailing their past performance, staff resumes, and examples of similar projects they've completed. Based on these statements a short list of three to five of the most qualified respondents is determined.

The RFP is then issued only to these "shortlisted" firms which then develop full proposals including cost, schedule, and technical response. (This should not be confused with Design-Build QBS discussed above.)

As part of BVS, DBIA supports stipends paid to the unsuccessful shortlisted proposers. These modest payments—usually between 0.01 percent and 0.25 percent of the project budget—help defray costs of proposal development incurred by design-build teams. Consistent with OMB Circular No. A–11 (2006), stipends enhance com-

petition and increase value by generating market interest and encouraging design-build teams to spend the time, money, and resources to provide creative, innovative, and complete proposals.

**Two-Step Is Better For Small Business**

In a single-step process, all design-build teams are asked to spend time and resources creating detailed proposals immediately, as opposed to simply submitting their qualifications. Due to the high costs of this first step—often reaching hundreds of thousands of dollar or even millions—many companies decide not to apply since their chances of final selection are so low. Small businesses in particular do not have the luxury to spend limited resources to apply for a project when the chance of being chosen may be less than ten percent.

If small businesses were only required to initially provide their qualifications under the two-step process, as opposed to a full proposal under the single-step process, many more would be able to participate. This is not only good for American small businesses, it also benefits the American taxpayer, and federal government who can be sure the most qualified companies were not scared away from a project simply due to the costs and risks of applying.

**Best Value Selection Recommendations**

1) To limit the use of single-step, DBIA joins with other organizations, including the American Institute of Architects testifying here today, and recommends that Congress limit the use of single-step design-build to projects that are less than $750,000. This threshold is based on U.S. Army Corps of Engineers guidance which was issued in August 2012. Further, it will assure that for larger more complex projects risks for all firms are held in check, thus allowing small firms a greater chance to compete in the marketplace.

2) We recommend Congress amend current law to encourage true short-listing of finalists in two-step design build. Under current law, agencies are required to shortlist between three and five teams. However, the law gives the agencies flexibility to increase the number of finalists if such an increase is "in the Federal Government's interest and is consistent with the purposes and objectives of the two-phase selection process." This exception is proving to be too broad and agencies regularly "shortlist" far more than five finalists. DBIA would like to work with this committee on appropriate legislative language to address this problem.

**CONCLUSION**

Thank you again for the opportunity to submit this statement. We look forward to working with this committee on the issues discussed and are ready to answer any questions you may have.

I

113TH CONGRESS
1ST SESSION

# H. R. 776

To amend title 31, United States Code, to revise requirements related to assets pledged by a surety, and for other purposes.

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IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 15, 2013

Mr. HANNA (for himself and Mr. GRAVES of Missouri) introduced the following bill; which was referred to the Committee on the Judiciary, and in addition to the Committee on Small Business, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

# A BILL

To amend title 31, United States Code, to revise requirements related to assets pledged by a surety, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Security in Bonding Act of 2013".

**SEC. 2. SURETY BOND REQUIREMENTS.**

Chapter 93 of subtitle VI of title 31, United States Code, is amended—

(1) by adding at the end the following:

**"§ 9310. Individual sureties**

"If another applicable law or regulation permits the acceptance of a bond from a surety that is not subject to sections 9305 and 9306 and is based on a pledge of assets by the surety, the assets pledged by such surety shall—

"(1) consist of eligible obligations described under section 9303(a); and

"(2) be submitted to the official of the Government required to approve or accept the bond, who shall deposit the assets with a depository described under section 9303(b).''; and

(2) in the table of contents for such chapter, by adding at the end the following:

"9310. Individual sureties.".

**SEC. 3. SBA SURETY BOND GUARANTEE.**

Section 411(e)(1) of the Small Business Investment Act of 1958 (15 U.S.C. 694b(e)(1)) is amended by striking "70" and inserting "90".

○

On Design Build Contracts

**[DISCUSSION DRAFT]**

113TH CONGRESS
1ST SESSION

# H. R. _____

To amend title 41, United States Code, to require the use of two-phase selection procedures when design-build contracts are suitable for award to small business concerns, and for other purposes.

---

IN THE HOUSE OF REPRESENTATIVES

M . . . . . introduced the following bill; which was referred to the Committee on _____

---

# A BILL

To amend title 41, United States Code, to require the use of two-phase selection procedures when design-build contracts are suitable for award to small business concerns, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "_____ Act of 2013".

**SEC. 2. DESIGN-BUILD SELECTION PROCEDURES.**

Section 3309 of title 41, United States Code, is amended—

(1) in subsection (d) by striking "agency determines with respect to" and all that follows through the period at the end, and inserting the following: "the head of the agency approves the contracting officer's justification that an individual solicitation must have greater than 5 finalists to be in the Federal Government's interest. The contracting officer must provide written documentation of how a maximum number of offerors exceeding 5 is consistent with the purposes and objectives of the two-phase selection process.";

(2) by adding at the end the following:

"(f) DESIGN AND CONSTRUCTION CONTRACTS.—Two-phase selection procedures shall be used for entering into a contract for the design and construction of a public building, facility, or work when a contracting officer determines that the contract has a value of $750,000 or greater, as adjusted for inflation in accordance with section 1908 of title 41, United States Code.

"(g) REPORTS.—

"(1) AGENCY REPORTS.—Beginning on the date that is 1 year after the effective date of this subsection, and for each of the 4 years thereafter, each

agency shall submit to the Comptroller General of the United States and publish in the Federal Register, an annual report regarding all cases in the preceding year in which—

"(A) more than 5 finalists were selected for phase-two requests for competitive proposals; or

"(B) for a contract that has a value of $750,000 (as adjusted for inflation in accordance with section 1908 of title 41, United States Code) or greater for which the two-phase selection procedures was not used.

"(2) GAO REPORT.—On the first full fiscal year that is 5 years after the effective date of this subsection, the Comptroller General of the United States shall publish a report that, based on the information provided in the agency reports required under paragraph (1), analyzes the degree to which agencies have complied with the requirements of this section.".

on Reverse Auctioning

**[DISCUSSION DRAFT]**

113TH CONGRESS
1ST SESSION

# H. R. _____

To amend the Small Business Act to prohibit the use of reverse auctions for construction procurements.

---

IN THE HOUSE OF REPRESENTATIVES

M__. _____ introduced the following bill; which was referred to the Committee on _____

---

# A BILL

To amend the Small Business Act to prohibit the use of reverse auctions for construction procurements.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "_____ Act of 2013".

**SEC. 2. REVERSE AUCTIONS PROHIBITED FOR CONTRACTS FOR CONSTRUCTION.**

The Small Business Act (15 U.S.C. 631 et seq) is amended—

(1) by redesignating section 47 as section 48; and

(2) by inserting after section 46 the following:

**"SEC. 47. REVERSE AUCTIONS PROHIBITED FOR CONTRACTS FOR CONSTRUCTION.**

"(a) IN GENERAL.—In the case of any contract for design and construction services suitable for award to a small business concern, reverse auction methods may not be used.

"(b) DEFINITIONS.—For purposes of this section—

"(1) The term 'reverse auction' means, with respect to procurement by an agency, a method of soliciting offers on the Internet, in which—

"(A) firms compete against each other in real time and in an open and interactive environment to arrive at the lowest bid price; and

"(B) each firm's identity and pricing are disguised.

"(2) The term 'design and construction services' means—

"(A) site planning and landscape design;

"(B) architectural and interior design;

"(C) engineering system design;

"(D) performance of construction work for facility, infrastructure, and environmental restoration projects;

"(E) delivery and supply of construction materials to construction sites; and

"(F) construction, alteration, or repair, including painting and decorating, of public buildings and public works.".

On Subcontracting Goals

**[DISCUSSION DRAFT]**

113TH CONGRESS
1ST SESSION

# H. R. _____

To amend the Small Business Act to permit prime contractors covered by a subcontracting plan pertaining to a single contract with a Federal agency to receive credit against such a plan for using small business subcontractors at any level of subcontracting, and for other purposes.

---

IN THE HOUSE OF REPRESENTATIVES

M_. _____ introduced the following bill; which was referred to the Committee on _____

---

# A BILL

To amend the Small Business Act to permit prime contractors covered by a subcontracting plan pertaining to a single contract with a Federal agency to receive credit against such a plan for using small business subcontractors at any level of subcontracting, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "_____ Act of 2013".

**SEC. 2. CREDIT FOR CERTAIN SUBCONTRACTORS .**

Section 8(d) of the Small Business Act (15 U.S.C. 637(d)) is amended by adding at the end the following:

"(16) CREDIT FOR CERTAIN SUBCONTRACTORS.—

"(A) IN GENERAL.—For purposes of determining whether or not a prime contractor has attained the percentage goals specified in paragraph (6)—

"(i) if the subcontracting goals pertain only to a single contract with the executive agency, the prime contractor shall receive credit for small business concerns at any tier that receive subcontracts pursuant to the subcontracting plans required under paragraph (6)(D) in an amount equal to the dollar value of work performed by such small business concerns; and

"(ii) if the subcontracting goals pertain to more than one contract with one or more executive agencies, the prime contractor may only count first tier subcontractors that are small business concerns.

"(B) DEFINITION.—For purposes of this paragraph, the term 'first tier subcontractor'

means a subcontractor who has a subcontract directly with the prime contractor.".

**SEC. 3. GAO STUDY.**

Not later than 365 days after the date of enactment of this Act, the Comptroller General of the United States shall submit to the Committee on Small Business of the House of Representatives and to the Committee on Small Business and Entrepreneurship of the Senate a report studying the feasibility of using Federal subcontracting reporting systems, including the Federal subaward reporting system required by section 2 of the Federal Funding Accountability and Transparency Act of 2006 and any electronic subcontracting reporting award system used by the Small Business Administration, to attribute subcontractors to particular contracts in the case of contractors that have subcontracting plans under section 8(d) of the Small Business Act that pertain to multiple contracts with executive agencies.

Statement on the record

**Mechanical Contractors Association of America**

to the

**Subcommittee on Contracting and Workforce**

Committee on Small Business

U.S. House of Representatives

For the hearing on

**"Building America: Challenges for Small Construction Contractors"**

May 23, 2013


**The Mechanical Contractors Association of America (MCAA) serves the unique needs of approximately 2,500 firms involved in heating, air conditioning, refrigeration, plumbing, piping, and mechanical service. We do this by providing our members with high-quality educational materials and programs to help them attain the highest level of managerial and technical expertise. MCAA includes the Mechanical Service Contractors of America, the Plumbing Contractors of America, the Manufacturer/Supplier Council, the Mechanical Contracting Education and Research Foundation and the National Certified Pipe Welding Bureau.**

**The Mechanical Contractors Association of America**
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June 4, 2013

The Honorable Richard Hanna, Chairman
The Honorable Grace Meng, Ranking Member
Subcommittee on Contracting and Workforce
House Small Business Committee
United States House of Representatives
Washington DC 20515

**Subject: MCAA's Statement for the Record on the hearing, *Building America: Challenges for Small Construction Contractors*, May 23, 2013**

Dear Mr. Hanna and Ms. Meng:

Please accept this letter as the formal statement for the record for the hearing you held on May 23, 2013, referenced above.

The Mechanical Contractors Association of America (MCAA) represents over 2,500 specialty construction businesses nationwide that operate across the full spectrum of mechanical construction public and private sector markets nationwide. MCAA members are engaged in heavy industrial, institutional, public facility, commercial and residential new construction, service and maintenance, and energy efficiency retrofit projects of all types. MCAA members perform mechanical systems construction, plumbing and hvac system installation, and mechanical and plumbing service and maintenance projects of all types.

MCAA member companies perform those types of projects variously as either prime contractors with public and private projects owners, or as subcontractors to primes contractors on various projects. Moreover, MCAA's membership is comprised primarily of small business firms, but a substantial number also have progressed from small business status to larger annual dollar volume operations. In all, MCAA member firms understand the broad purpose of the Small Business Committee's mission with respect to Federal construction contracting from both the prime contractor and subcontractor perspectives, and respectfully commend the committee for its work in recent years in enacting several constructive good-government reforms in the Federal construction market.

The topics of the hearing on May 23rd continue in that line of good-government, transparent contracting reforms that is essential for the goals of the committee and the overall responsibility of oversight of the construction procurement process for the benefit of small business and the efficiency of agency construction program effectiveness.

MCAA fully supports all four topics on the hearing docket and suggested reforms embodied in them plus an additional item in Point 5 below.

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1. ***The Security in Bonding Act of 2013*, H. R. 776** - MCAA joins with the great many other construction prime contractor and subcontractor groups in commending Representative Hanna for recognizing that the procedures under the Miller Act that permit individual surety bonds should be reformed to prevent loss to the Government and injury to subcontractors and suppliers in the event that a non-corporate surety bond is accepted and not backed by sufficient assets to meet the bond obligation. MCAA agrees with the broad industry consensus that the integrity of the surety bonds on a Federal project is key to taxpayer and agency protections and prevention of loss and competitive impairment for subcontractors and suppliers on those projects, who don't have the protections of mechanics' liens and must rely on the assets backing the bonds to prevent losses in the event of prime contractor defaults. This is a good-government reform that strengthens the Federal construction procurement process for all stakeholders.
2. ***Lower-tier subcontracting goal credits*** - MCAA also agrees with the proposal to allow covered construction prime contractors and subcontractors to take small business subcontracting goal credits for lower-tier subcontracting awards, which serves the overall interests of the government's small business goals while at the same time allowing agency projects to also benefit from project performance flexibility. With added safeguards against double counting by prime contractors and subcontractors for the same lower-tier awards, the Subcommittee's proposal is a win/win/win proposal for agency projects, the national small business contracting goals, and small business primes and subcontractors at all tiers.
3. ***Two-step design/build procurement methods*** - MCAA also commends the Subcommittee for looking into ways to modulate the growing use of design/build procurement, to continually monitor the growing use of alternative procurement methods to make sure that small businesses and government agencies are both being well served by procurement procedures in the interests of the agency programs overall and small business and the taxpayers in general. MCAA supports the Subcommittee's proposal to make sure that agencies adhere to the two-step design/build procedures, and short list no more than 5 design/build teams after the initial responses to the request for qualifications, unless there is a specific justification for short-listing more teams. The significant shift of direct Federal construction procurement from low-bid selection (now only 10% of dollar volume) to negotiated selections procedures – design/build chief among those (now fully 90% of overall dollar volume – perhaps more for some agencies) should be a continual subject for examination for the committee's procurement jurisdiction. See Point 5 below.
4. ***Ban internet reverse auctions for construction prime contractor low-bid selection*** - MCAA commends the Subcommittee for finally acting on the U.S. Army Corps of Engineers' recommendation, after the USACE pilot study conducted in 2004, that agencies abjure altogether the use of internet reverse auctions for direct Federal construction prime contractor low-bid selection decisions. As the USACE duly noted after comprehensive study, there are no provable project cost advantages from reverse auctions ( a form of open electronic bid shopping of the prime contractor's initial bid), exposing the agency to only significant project drawbacks from an exposed bid shopping system that forfeits all the beneficial discipline of the sealed, low-bid system. Imprudent bidding is engendered by open bid shopping at the prime contract level, and the agency and prime contractors and subcontractors alike, small business and otherwise,

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are detrimentally exposed to predatory prime bidders that would buy the job, and then make up for the lack of discipline in subcontract bid shopping, substitutions, claims and disputes. In those cases, the project suffers and so do all of the project participants.

Virtually all construction prime contract and subcontractor groups join in supporting the USACE and now the Subcommittee's proposal to ban internet reverse auctions for construction low-bid prime contractor selection procedures. Attached is MCAA's policy statement against low bid auction procedures, which is typical of many industry group statements. (Attachment 1).

MCAA commends the Subcommittee for acting on the USACE recommendations, and accepting USACE's fact-based, and evidence-based, analytical procedure backing up their recommendation and the Subcommittee action. MCAA also would recommend that procedure with rigorous, fact-based analysis for other procurement reforms proposals, notably the subcontractor bid listing proposal discussed in Point 5 below.

***So, MCAA is in full support of the subjects and types of analysis proposed for the procurement reforms that were subjects of discussion at the May 23rd hearing, except one. MCAA would respectfully request that the Subcommittee take up consideration of H.R. 1942, the Construction Quality Assurance Act of 2013, which would inhibit the universally condemned practices of subcontract bid shopping and bid peddling on direct Federal prime contractor low-bid selection procedures.***

5. ***Include H.R. 1942, subcontract bid listing in the Subcommittee's positive reforms*** – MCAA would urge the Subcommittee to formally consider adding H.R. 1942, the subcontractor bid listing reforms, to its set of proposals to benefit small business and agency procurement programs. H.R. 1942 is fully consistent with the proposed ban on internet reverse auctions for prime contractor low-bid selection, and shares in all the basic reasons cited in the USACE report. That is, imprudent and predatory bidding procedures are just as detrimental at the subcontract level as they are at the prime contract level, and all the detrimental impacts that devolve onto the agency project and the taxpayers are identical in both types of abuses.

   In fact, all the prime contract and subcontractor groups that join in opposing internet reverse auctions (electronic bid shopping at the prime contract level) join together in a statement in the *Guidelines for a Successful Construction Project* (Attachment 2), condemning post-award prime contractor subcontract bid shopping and bid peddling as "abhorrent" business practices that are detrimental to successful project performance. And, the American Society of Professional Estimators condemns the practice as unethical (Attachment 3).

   However, anomalously, when it comes to legislating against the universally reviled practice, with a long-overdue good-government, transparent contracting reform, it is only the prime contractor group, primarily Associated General Contractors of America, that breaks ranks and pleads administrative inconvenience on behalf of the agencies. At other times, AGC has said there is no proof of the prevalence of the abuses, begging the question then, what need of

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general industry guidelines and statements against the "abhorrent" practices, not to mention why do some 13 states and other state agencies adopt bid listing practices in the face of these evidentiary red herrings?

At the May 23rd hearing, the AGC representative also made some factually incorrect objections in response to a question from Ranking Member Meng on the advisability of bid listing. It was said that the General Services Administration had adopted the proposed bid listing protection for only some 5 or 6 years. In fact it was 20 years, from 1963 to 1983. Also, it was said that there were unspecified yet innumerable contract protests relating solely to the bid listing process. In fact, a review of the regulatory record relating to these issues back in 1977 reveals that may of those protests related to other contract specification issues as well. Moreover, a review of some of the GAO protests shows that several were the result of the of the failure of contracting officer to put the bid listing requirements in the contract specifications in the first place, hardly an argument against the substance of the procedure. Furthermore, the period of time mentioned – pre-1983, was one of highly adversary contracting relations between prime contractors and agencies, going well beyond just bid listing, and giving rise to a number of contracting reform efforts, including the 1984 Competition in Contracting Act and agency Partnering initiatives as well.

The overall point is that the opponents of bid listing, proponents of leeway to engage in post-award bid shopping and peddling, succeed too often in raising time worn objections to subcontract bid listing that are just that, and are now long surpassed by events and contracting practices. For example, the objections to bid listing on the basis of administrative inconvenience is relevant to industry practices as they were in 1983 – when all projects were low-bid, but today just 10% of contract value is awarded on a low-bid basis - rather than those that prevail today. Even in the regulatory comment file back then in 1977, not all General Services Administration regional officials opposed the subcontract bid listing procedures, and in fact some said they thought it was an effective deterrent to post-award bid shopping by unscrupulous prime contractors. Other GSA region comments objected only to administrative inconvenience, not the substance or effectiveness of bid listing, which was based on the fact that back then all awards were low-bid awards.

Another frequently raised red herring is that bid listing interferes with the prime contractor's ability to vet the performance ability and qualifications of prospective subcontractors before entering into a subcontract with that firm. Again, that's an overstatement at best, as industry best practices require that the prime contractor vet the prospective subcontractor's performance record, bonding capacity and qualifications in the pre-bidding prequalification process, well before relying on their subbid in submitting the sealed bid to the owner. It is unassailable that most major prime contractors prequalify their subs before the bidding process begins. (In fact, after the bid opening, H.R. 1942 allows ample leniency for changed conditions allowing proper substitutions, except for post-award bid shopping and bid peddling.)

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Again, this facile objection begs the question, if subcontractor bid listing is an obstacle to subcontractor qualification procedures, then why do some 13 states and other agencies hazard these problems, or how do they meet them? The answer is plain, the problem is chimerical, or at least entirely avoidable by pre-bidding prudence; the objection serves merely as a roadblock to reforms that would present a hindrance to post-award bid shopping and bid peddling – scourges of fair prime contractors and subcontractors and successful projects. In fact, some agencies that use subcontract bid listing today attest to its effectiveness in making timely responsibility determinations, and avoiding disputes and claims.

See Attachment 4, letters from the Missouri Department of Administration, the California Department of General Services, and Los Angeles Unified School District all lauding the effectiveness of bid listing requirements like H.R. 1942, and answering all the various objections raised above. These letters were submitted to MCAA in response to questions relating to H.R. 1778 in the 112th Congress, which is identical to H.R. 1942 in the 113th Congress.

As set out above, in 1984 Congress enacted the Competition in Contracting Act to get away from the myriad of problems stemming from exclusive use of low-bid prime contractor selection procedures, and the pendulum swung from exclusively low-bid procedures in 1983, to just around 10% ($ volume) low-bid in 2013. Some would say that there is a now an overreliance on use of negotiated selection procedures by some agencies, and that a return to better balance with use of low-bid selection may be in the taxpayer's best interest. MCAA agrees with that analysis. (See Attachment 5, USACE letter to Senator Chambliss on question relating to use of bid listing, dated January 16, 2013.)

In 1984, Congress allowed agencies to walk or run away from the low-bid system – and they did. Congress did not then go back to address and remedy the underlying problems with the low-bid system that would permit a restoration of a more cost-effective balance between use of negotiated selection procedures for projects of appropriate scope, and the use of an amended low-bid system for jobs that would not otherwise warrant the added expense and administrative overhead of negotiated selection procedures. So again here, the administrative convenience argument too may have turned 180 degrees since 1983. Now, some agencies negotiate virtually all projects above the $1 million threshold, requiring a degree of administrative attention far greater than sealed bid, price-only selection procedure. If H.R. 1942 were enacted to stem some of the prominent abuses in the low-bid market, price-only procedures may again be used more frequently by agencies, thus saving administrative expense of the contract negotiation selection process and thereby promote cost-effective, successful project outcomes.

Moreover, as mentioned previously, some 13 states use a type of bid listing for their construction procurement programs. Some others have sub bid depositories, or even more stringent and protective separate prime contracting laws to remedy construction prime contractor and subcontractor selection abuses on their public construction projects. Attachment 6 below details the latest of these state adoptions. Just last week in Wisconsin the state budget resolution put in place a very effective and stringent sub-bid depository law to

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stem bid shopping abuses – and the reforms were supported by the entire industry – prime contractors and subcontractors alike.

In conclusion, the last remaining obstacles raised to long-overdue adoption of bid listing are the too familiar straw men of privity of contract and private market discipline. That is, opponents of bid listing have in the past successfully raised the argument that privity of private subcontracting decisions should prevent adopting of bid listing regulations – that is, the argument goes, the subcontracting decisions should remain a matter of private contract decision making, or that the market should be left to operate to allow subcontractors to choose not to bid to prime contractors that bid shop. (See Attachment 7, *Philadelphia Inquirer* news article dated March 20, 2013 for a particularly egregious incident of post-award bid peddling.)

Congress decisively dispatched the privity of contract/private market discipline argument when it enacted the very fair and detailed owner/prime contractor/subcontractor payment rules in the 1987 Prompt Payment Act. Congress then accepted the market realities that Federal contract payment rules at the subcontract level are decisively implicated in successful project performance and are very properly a matter of procurement rule governance. The same is certainly true for subcontractor selection procedures – as subcontractors perform the majority of work on most projects of any consequence, and robust competition for that work is in the public interest. Moreover, with Congress' and the Administrative Conference of the U.S. recent emphasis on Federal contractor ethics policies, it remains entirely appropriate for Congress to close the longstanding ethical loophole in low-bid procedures that countenances post-award bid shopping and bid peddling – that are widely acknowledged by the industry to constitute unethical business practices. Furthermore, procurement rules are in danger of lagging judicial rulemaking in this area, as courts are growing more inclined to apply False Claims Act jurisdiction over prime contractor pricing proposals. (*See, Hooper v. Lockheed Martin, 688 F.3d 1037, 9th Cir. 2012.)* It would seem a short step to applying those same principles to low-bid pricing where the prime contractor conducts a post-award auction after submitting the low bid, further "buying out" the job with bid shopping auctions that increase the prime contractor's revenue with no commensurate benefit to the project or the taxpayers.

In conclusion, MCAA respectfully requests that the Subcommittee open up consideration of the construction procurement reforms discussed on May 23rd with a view to incorporate H.R. 1942 in that legislative proposal banning Internet reverse auctions.

Respectfully submitted,

John McNerney

John McNerney, General Counsel MCAA

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Attachments:

1. MCAA Statement on the Use of Internet Reverse Auctions for Construction Services
2. Guideline on Bid Shopping and Bid Peddling
3. The American Society of Professional Estimators Code of Ethics
4. State Agency Letters
    - 4.1 State of Missouri Office of Administration letter, dated March 5, 2012
    - 4.2 California Department of General Services letter, dated July 30, 2012
    - 4.3 Los Angeles Unified School District Office of Government Relations letter, dated March 19, 2012
5. USACE letter on bid listing, dated January 16, 2013
6. Wisconsin single prime contracting and sub-bid depositary budget legislation and supporting material
7. *Philadelphia Inquirer* article dated March 20, 2013: *Construction owners charged with extorting employees*

## MCAA Statement on the Use of Internet Reverse Auctions For Construction Services

MCAA considers the use of Internet reverse auctions for procurement of construction services to be *problematic for owners and contractors alike.*

While most applications of various e-commerce and Internet use (project websites, for example) have demonstrated or hold great promise for productivity and service improvements for owners and the industry at large, the same can not be said for Internet reverse auctions. MCAA considers them to be little more than a form of *electronic bid shopping*; that is, disclosing the proprietary bid price of a competitor to all others for the purpose of obtaining even lower bids.

While reverse auctions may be judged appropriate by some owners for certain well defined projects on a case-by-case basis, an across-the-board policy dictating reverse auction, price-only selection for all projects would be just as short sighted as dictating a single type of project delivery system for projects of all types.

MCAA, along with the industry overall, long ago recognized the long-term detrimental impact of an across-the-board policy of low-bid, price-only selection criteria, and the bid shopping and chopping practices that are inherent in that system and undermine project success, such as: fragmented scopes of work and scope disputes, unnecessary changes and inordinate delays, and overhead waste relating to defensive contract administration, claims, disputes and lawsuits.

In fact, many of the innovations in construction procurement, contracting and project administration over the past 20 years have been in direct response to the inefficiencies that stem from low-bid, price-only selection criteria. Those innovations include value-based selection criteria, careful past performance evaluations, prequalification screening of competitors, project partnering, integrated project contracting and delivery systems, design-build services delivery, and other positive contract administration procedures, including dispute avoidance mechanisms and measures to reduce project dispute overhead costs. Overall, these developments have represented a better investment in overall project quality and life-cycle cost effectiveness.

Unfortunately, Internet reverse auctions can be seen as a way to adapt new technology to return to many of the problems of the past and give back the project efficiency gains that have resulted from innovative, value-added contracting procedures. Nevertheless, given recent experience with reverse auctions, MCAA members have encountered certain approaches that tend to ameliorate the more difficult aspects of the process as discussed below.

> **Well-defined scope of work** - Reverse auctions are least likely to lead to problem jobs in those cases where the owner has firm, detailed design drawings and specifications. Recent studies strongly indicate that project planning up front is the best predictor of project success and problem avoidance.

> **Use of best-value prequalification criteria** - Best-value prequalification criteria should be rigorously applied. The criteria should include demonstrated superior past performance related to project performance overall, including cost and schedule delivery, project safety experience, workforce training and development investments, and project management and site supervision expertise relating to equipment purchasing and other aspects of contract administration.

> **Transparency of auction procedures** - The reverse auction procedures should provide maximum transparency in the interest of fairness for all competitors. The identity of all participants should be disclosed, as well as the dollar amount and ranking of all bids. Similarly, the owner should disclose the existence and amount of any reserved price above which the

project would not be let. Just as laws pertaining to the auctions of goods are designed to protect fairness in the process and prevent fraud and abuse, the owner and Internet service provider for reverse auctions of construction contracts should make sure that all competitors are extended the same privileges under the auction rules.

**> Provide adequate procedures for redress of errors** - The auction procedures should provide careful safeguards against both imprudent and administrative mistakes in bidding, as overall project success is strongly compromised by mistakes in selection decisions. Even at this early stage, it is widely recognized that the reverse auction process often tempts hasty and imprudent bidding given the tight time frame and competitive context of the auction procedure. The industry recognizes that selection based on competitive frenzy as opposed to more discerning judgment is a high risk factor for project success. Bid decrements and the time intervals for bid adjustments should be appropriate for the scope and size of the project. Clerical mistakes also should be excused in the auction process in the manner of treatment of those mistakes in the sealed bidding context. Overall the owner should not design the process as though construction service auctions can be conducted in the same way as commodities procurement.

**> Provide adequate safeguards against other abuses** - The reverse auction procedures should also contain adequate safeguards against fraud and abuse, including express warranties against fictitious ("phantom bidders") bidders and other conditions that would constitute fraud in the inducement of the contract award. Moreover, any procedure for post-bid negotiated awards should be disclosed up front so competitors can fairly judge whether they can afford to compete. Similarly, if post-bid price increases are to be permitted, that too should be disclosed up front.

**> Policy reservations** - Notwithstanding adherence to the suggestions listed above, MCAA member experience suggests that reverse auctions remain a relatively new, untested and unproven method to actually lower construction costs without compromising project success.

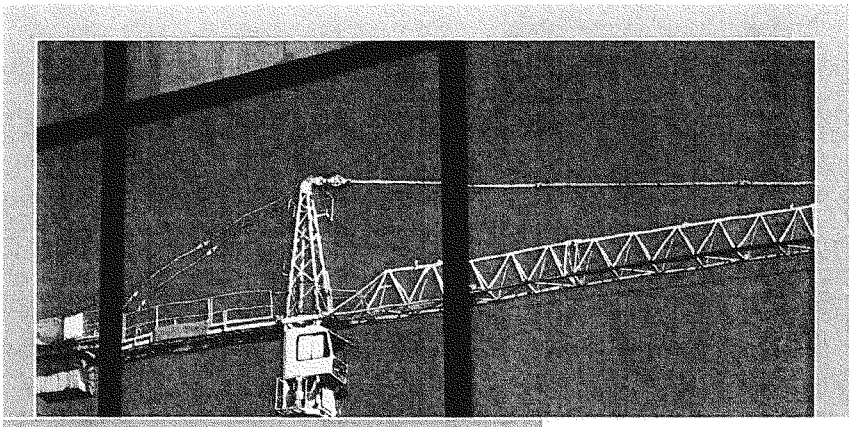
MCAA contractor experience with Internet reverse auctions suggests that the last bid in a reverse auction is not always the lowest and best price that may have been submitted even under sealed bidding procedures. Owners should be aware that a comparison of the opening bid with the last bid is not a valid indicator of actual cost savings on the project. Moreover, while open competition is good policy generally, even with careful prequalification screening, the auction process prompts fast and furious competitive judgments more than prudent decision-making. Negative experiences could significantly shrink the pool of willing competitors, and deliver negative project outcomes.

In conclusion, early experience suggests that the risks of mistakes, misjudgments and the added costs of Internet services may well in many cases outweigh the *perceived costs savings* realized through the use of reverse auctions.

MCAA will continue to monitor experience with reverse auctions for a continuing factual assessment of their costs and benefits and effect on project outcomes.

**Footnote** - This statement does *not* address the many ways that public and private contracting practices vary with respect to contractor selection rules and procedures generally and reverse auctions in particular. In the main, Federal, state, and local open competition/sealed bidding rules prohibit reverse auctions for construction. The Federal procurement policy is to continue to use sealed bidding/competitive negotiations without price disclosure for construction services, even though one agency has Congressional authorization to test pilot reverse auctions. Another agency is attempting to categorize some construction/repair/alteration projects as "commercial items" to avoid construction procurement rules. At the state level, a growing number of states are amending procurement laws to permit reverse auctions for commodities, but are careful to rule out reverse auctions for construction services.

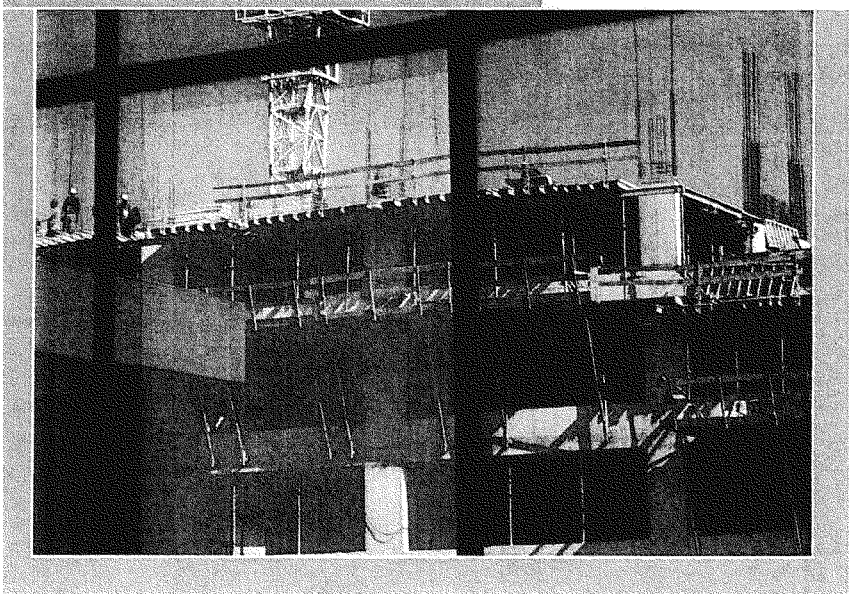
**Approved by the MCAA Board of Directors, February 28, 2004**



# GUIDELINES

## FOR A SUCCESSFUL CONSTRUCTION PROJECT

American Subcontractors Association



# Guidelines For A Successful Construction Project
# Table of Contents

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Clicking on an entry in the Table of Contents will take you directly to that Guideline. In a Guideline, clicking on a reference to another Guideline will take you to the referenced document.

## Mission Statement

The Associated General Contractors of America, the American Subcontractors Association, and the Associated Specialty Contractors have agreed to work together to develop, maintain and promote *Guidelines for a Successful Construction Project.* The Guidelines represent the joint efforts and approval of these organizations who will continue to address industry concerns as the need arises.

## A. Introduction & Overview



## B. Bidding Processes



## C. Preconstruction Planning

# B.4
# Guideline on Bid Shopping and Bid Peddling

Bid shopping and bid peddling are abhorrent business practices that threaten the integrity of the competitive bidding system that serves the construction industry and the economy so well.

The bid amount of one competitor should not be divulged to another before the award of the subcontract or order, nor should it be used by the contractor to secure a lower proposal from another bidder on that project (bid shopping). Neither should the subcontractor or supplier request information from the contractor regarding any subbid in order to submit a lower proposal on that project (bid peddling).

An important, but often unrecognized, business asset of the construction contractor is its proprietary information. Proprietary information includes the price, the design or novel technique, or an innovative approach used in preparing a proposal.

The preparation of bids, proposals, submissions or design-build documents is the result of professional consideration which is the intellectual property of the preparer, and so any such information should be considered proprietary.

It is unethical to disclose to others, any information that is provided with an expectation that such information will be kept confidential.

## *The American Society of Professional Estimators Code of Ethics*

**Introduction**

The ethical principles presented are intended as a broad guideline for professional estimators and estimators in training. The philosophical foundation upon which the rules of conduct are based is not intended to impede independent thinking processes, but is a foundation upon which professional opinions may be based in theory and in practice.

Please recognize that membership in and certification by the American Society of Professional Estimators are not the sole claims to professional competence but support the canons of this code.

The distinguishing mark of a truly professional estimator is acceptance of the responsibility for the trust of client, employer and the public. Professionals with integrity have therefore deemed it essential to promulgate codes of ethics and to establish means of insuring their compliance.

**Preamble**

The objective of the American Society of Professional Estimators is to promote the development and application of education, professional judgment and skills within the industry we serve. Estimators must perform under the highest principles of ethical conduct as it relates to the protection of the public, clients, employers and others in this industry and in related professions.

The professional estimator must fully utilize education, years of experience, acquired skills and professional ethics in the preparation of a fully detailed and accurate estimate for work in a specific discipline. This is paramount to the development of credibility by estimators in our professional service.

Estimating is a highly technical and learned profession and the members of this society should understand their work is of vital importance to the clients and to the employers they serve. Accordingly, the service provided by the estimator should exhibit honesty, fairness, trust, impartiality and equity to all parties involved.

**Canon #1**
*Professional estimators and those in training shall perform services in areas of their discipline and competence.*

1. Estimators shall to the best of their ability represent truthfully and clearly to a prospective client or employer their qualifications and capabilities to perform services.

2. The estimator shall undertake to perform estimating assignments only when qualified by education or years of experience in the technical field involved in any given assignment.

3. The estimator may accept assignments in other disciplines based on education or years of experience as long as qualified associate, consultant or employer attests to the accuracy of their work in that assignment.

**Canon #4**
*Professional estimators and those in training shall safeguard and keep in confidence all knowledge of the business affairs and technical procedures of an employer or client.*

1) Privileged information or facts pertaining to methods used in estimating procedures prescribed by an employer, except as authorized or required by laws, shall not be revealed.

2) Treat in strict confidence all information concerning a client's affairs acquired during the fulfillment of an engagement and completion of an estimating procedure.

3) Serve clients and employers with professional concern for their best interests, provided this obligation does not endanger personal integrity or independence.

**Canon #5**
*Professional estimators and those in training shall conduct themselves with integrity at all times and not knowingly or willingly enter into agreements that violate the laws of the United States of America or of the states in which they practice. They shall establish guidelines for setting forth prices and receiving quotations that are fair and equitable to all parties.*

1) By not participating in bid shopping. Bid shopping occurs when a contractor contacts several subcontractors of the same discipline in an effort to reduce the previously quoted prices. This practice is unethical, unfair and is in direct violation of this Code of Ethics.

2) By not accepting quotations from unqualified companies or suppliers. Every effort should be made to pre-qualify any bidder to be used.

3) By not divulging quotes from subcontractors and suppliers to competitors prior to bid time in efforts to drive down the prices of either. Should quotes be received from subcontractors or suppliers that are excessively low or appear to be in error, the firm should be asked to review its' price. When making this request the quotes of others shall not be divulged.

4) By not padding or inflating quoted bid prices. An unethical practice for professional estimator is to pad or inflate quotes when bidding with firms known for bid shopping. If not a violation of applicable laws, a professional estimator should not provide quotes to known bid shoppers. However, it is not unethical to submit quotes with different values to different contractors, provided there are sound business reasons to justify the differences in the quotes.

5) Professional estimators shall not enter into the unethical practice of complimentary bids (also known as comp bids). Complimentary bidding is a violation of this Code of Ethics.

**Canon #6**
*Professional estimators and those in training shall utilize their education, years of experience and acquired skills in the preparation of each estimate or assignment with full commitment to make each estimate or assignment as detailed and accurate as their talents and abilities allow.*

1) To formulate an accurate estimate in any discipline, a full review must be made of all related documents. Any other approach could cause errors or omissions that may endanger professional integrity and reliability.

Jeremiah W. (Jay) Nixon
Governor

Catherine F. Brown
Director

Doug Nelson
Acting Commissioner

State of Missouri
OFFICE OF ADMINISTRATION
Division of Facilities Management
Design and Construction
730 Truman Building, 301 West High Street
Post Office Box 809
Jefferson City, Missouri 65102
INTERNET: http://www.oa.mo.gov/fmdc
E-MAIL: FMDCMAIL@oa.mo.gov

(573) 751-3338
FAX (573) 751-7277

March 5, 2012

John McNerney
General Counsel
Mechanical Contractors Association
of America
1385 Piccard Drive
Rockville, MD 20850

RE: Construction contracting low-bid award subcontract bid listing procedure; how H.R. 1778 relating to Federal low-bid construction contract bid listing proposal compares favorably with Missouri state agency procurement practices.

Dear Mr. McNerney:

In response to your questions concerning how low-bid construction contract selection procedures work in practice where the prime contract bidder is required to list major subcontractors, I herby submit the very positive report of Missouri state procurement practice using bid subcontractor listing very similar to that required by H.R. 1778.

As part of my duties with the State of Missouri Division of Facilities Management, Design and Construction, I supervise and provide day to day legal counsel for operations in the Division's Contracts Unit. Though the current economy has slowed new construction and maintenance of state facilities, the State of Missouri has typically had significant sums of construction under contract at any given time, and lets contracts on a daily basis to procure and maintain the necessary facilities for its government-related operations.

The State of Missouri, as a matter of policy and custom, has for many years required contractors bidding on construction projects to disclose the names of their larger subcontractors, as well as subcontractors that are relied upon the contractor to meet state statutory/regulatory/policy goals pertaining to contracting with minority, women, and service-connected disabled veteran business enterprises. The State has required contractors to list major subcontractors for many years as a matter of sound proprietary business discretion. The State adopted this policy as a matter of sound agency purchasing discretion.

The State considers these contractual requirements to be significant and does not in any instance deviate from this requirement – a bidding contractor that fails to disclose its subcontractors as required will be deemed to be non-responsive and its bid will not be considered by the State.

Furthermore, state construction contracts awarded incorporate provisions identifying the subcontractors relied upon by the contractor in submitting its successful bid; and prohibit the contractor from substituting subcontractors without the acquiescence of the State. The subcontractor is not required to enter into or execute the contract, and there is no privity of contract between the subcontractor and the State – however, the contractor cannot unilaterally substitute subcontractors subsequent to entering into the original contract without acquiescence by the State.

The State of Missouri's bidding and contractual requirements regarding subcontractor disclosure, participation and substitution further significant state interests, including the following:

1) The State is able to assess and determine the responsiveness and the ability of the contractor to satisfy its contractual obligations it proposes to assume. Missouri law requires that a contract be awarded to the lowest responsible responsive bidder. Subcontractor identification and disclosure allows the State to assess and determine the contractor's ability and proposed plan to complete its contractual obligations, and whether the contractor has the necessary business and professional relationships in order to successfully complete the contractual obligations its proposes to assume.

2) Subcontractor identification and disclosure requirements, as well as contractual restrictions on subcontractor substitution, avoid adverse consequences that result from post-award bid shopping and bid peddling. These contractual provisions and restrictions allow the State to avoid post-award bid shopping auctions, with the successful prime contractor selling the project to a subcontractor willing to undercut its costs and prices after the prime contract has been awarded, and avoid problems associated with substitution of substandard materials and poor performance, contract disputes and defensive contract administration, and claims and litigation associated with underbidding construction projects and procurement.

3) Subcontractor identification and disclosure requirements, and contractual restrictions on subcontractor substitution, allow the State to ensure that the State meets its goals of ensuring that certain proportions of its construction to minority-owned, women-owned, and service-connected disabled veteran-owned, business enterprises. The State of Missouri requires bidding contractors to disclose as part of its bid the identities of the contractors/subcontractors it intends to rely upon it achieving these goals in order to responsively bid in response to a request for proposals; and further does not allow the successful bidder to potentially avoid these goals by later substituting participation of these contractors/subcontractors that the State relied upon in awarding the contract, without acquiescence by the State.

In its periodic review of its contracting practices, the State has consistently chosen to retain the requirement that contractors list major subcontractors because of the many advantages for successful project delivery, improving the competitiveness of State projects in the construction market, and the enhanced value return to Missouri taxpayers by following sound and responsible contracting policies. The State does not believe that Missouri taxpayers would benefit if prime contractors were allowed to conduct post-award subcontract bid shopping or peddling that would not return any value to the State's construction programs and Missouri taxpayers. From the

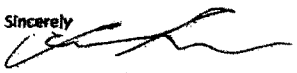
State's perspective, permitting post-award bid shopping allows unscrupulous contractors to exploit and force subcontractors to perform at the contractor's price. Subcontractor disclosure and listing improves competitiveness in the market overall by requiring best business practices and thereby attracts more highly qualified firms to compete for State jobs and promotes top-flight performance by those firms.

The construction industry accepts the validity of requiring listing of major subcontractors as a sound requirement of overall project planning and administration. As project owner, the State is vitally concerned with all participants on State construction projects. Contractors bidding for State projects have accepted the practice without challenge or dispute. The State has not encountered legal challenges resulting from its policies requiring bidder to disclose major subcontractors and successful bidders to use named subcontractors. In fact, subcontractor listing and disclosure does not interfere with the contractor's privity of issue with its subcontractors, but allows the contractor to select its subcontractors while ruling out post-bid exploitation of subcontractors and the attendant risks to the State project and taxpayers.

The use of major subcontract bid listing presents no administrative burdens, either; and in fact helps avoid many more problems than it causes. The State administers the requirement efficiently, and applies sound business judgment in allowing substitutions for named subcontractors when required by the facts and circumstances (similar to the provisions of H.R. 1778 that set out specific reasons for allowing substitutions of named subcontractors). The State of Missouri can attest that the use of subcontractor disclosure and listing has avoided many problems and has caused few if any administrative burdens whatsoever.

Thank you for the opportunity to discuss the benefits of beneficial public contracting requirements such as subcontractor listing and disclosure. If I can provide any further information regarding this issue, please feel free to contact me.

Sincerely



Lawrence A. Weber
Deputy Director of Administration-Chief Counsel

DGS CALIFORNIA DEPARTMENT OF GENERAL SERVICES

Governor Edmund G. Brown Jr.

July 30, 2012

John McNerney, General Counsel
Mechanical Contractors Association of America
1385 Piccard Drive
Rockville, MD 20850

H. R. 1778 the Construction Quality Assurance Act of 2011

Dear Mr. McNerney:

Since 1963, the State of California, under Public Contract Code Section 4100 et. seq., known as the Subletting and Subcontracting Fair Practices Act (Act), has required contractors bidding on low bid public works projects to list the names of all subcontractors performing in excess of one half of one percent of the contract value. In addition, recent California Law requires listing of all Disabled Veteran Business Enterprises as well. The California Legislature enacted these laws for the express purpose of preventing bid shopping, bid peddling, fostering fair competition and improved quality of materials and workmanship among contractors and subcontractors competing for state public works contracts.

The Department of General Services administers subcontractor listings and substitutions pursuant to the statutory scheme set forth in the Act. An important element of the Act is the ability of the listed subcontractor to formally contest a contractor's request for substitution. This provision provides due process avoiding capricious substitutions on the part of contractors and further ensuring that listed subcontractors are dealt with in a fair and reasonable fashion.

H. R. 1778 is modeled after the California Public Contract Code cited above and as such the Federal Government should expect similar results in the preventing of bid shopping, bid peddling, improved competition, and improved value for the taxpayers.

Sincerely,

Fred Klass
Director

cc: Anna M. Caballero, Secretary, State and Consumer Services Agency
Richard Sawhill, Executive Vice President, ARCA/MCA Southern California

*Executive Office/State of California |State and Consumer Services Agency*
*707 3rd Street, 8th Floor | West Sacramento, CA 95605 | t 916.376-5000 f 916.376-5018*

**LOS ANGELES UNIFIED SCHOOL DISTRICT**
**Office of Governmental Relations**

John E. Deasy, Ph.D.
*Superintendent of Schools*

Edgar Zazueta
*Director*

March 19, 2012

John McNerney
General Counsel
Mechanical Contractors Association of America
1385 Piccard drive
Rockville, MD 20850

RE: The California Subletting and Subcontracting Fair Practices Act

Dear Mr. McNerney:

The Los Angeles Unified School District (District) has been asked to comment on how California's "Subletting and Subcontracting Fair Practices Act" (Act) works, specifically its listing requirements. The District is pleased to report the Act has been good for public works construction projects in California and has been good for the Los Angeles Unified School District.

California has operated in compliance with the Act since before 1963. Specifically, 4104 (a) (1) of California's Public Contract Code states that:

*"(a) (1) The name and the location of the place of business of each subcontractor who will perform work or labor or render service to the prime contractor in or about the construction of the work or improvement, or a subcontractor licensed by the State of California who, under subcontract to the prime contractor, specially fabricates and installs a portion of the work or improvement according to detailed drawings contained in the plans and specifications, in an amount in excess of one-half of 1 percent of the prime contractor's total bid or, in the case of bids or offers for the construction of streets or highways, including bridges, in excess of one-half of 1 percent of the prime contractor's total bid or ten thousand dollars ($10,000), whichever is greater."*

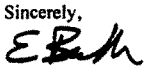
The Los Angeles Unified School District is winding down a $20 billion school construction program considered the largest current public works project in the United States. At the conclusion of our construction program, the District will have provided new classroom seats for 159,000 children in 129 new schools, while also completing 22,000 renovation and repair projects throughout our existing schools. The District believes the Act has contributed to the success of our program in a number of ways including:

- We know before we award a contract that our prime is using quality subs that meet our prequalification requirements;
- We have an owner controller insurance program and can make sure the named subs have safety records that make them eligible to participate in our program;
- We can check to make sure the named subs are appropriately licensed to perform the work for which they are named;

- We can make sure that our prime contractor fully understands the scope for which he is to perform and is hiring the appropriate expertise with the appropriate qualifications to do that work;
- We have assurances that a prime has had communications with a named sub and understands the requirements and the costs associated with performing the named work and has provided us with a responsible bid under which he can perform our contracts.

We understand and agree that you would share our convictions on this matter with lawmakers in Congress in support of the industry's efforts to establish a comparable change in direct Federal public construction practices for Federal agencies. We submit that using California's subcontractor listing law as a model and amending Federal law would be a very constructive change and would serve agencies and the taxpayers well.

Sincerely,



Eric Bakke
Legislative Advocate
Los Angeles Unified School District

DEPARTMENT OF THE ARMY
U.S. ARMY CORPS OF ENGINEERS
441 G STREET, NW
WASHINGTON, DC 20314-1000

REPLY TO
ATTENTION OF

JAN 16 2013

Engineering and Construction Division

Honorable Saxby Chambliss
United States Senate
416 Russell Senate Office Building
Washington, D.C. 20510- 1007

Dear Senator Chambliss:

This is in response to your letter dated December 13, 2012, to Lieutenant General Thomas Bostick concerning H.R. 1778, the "Construction Quality Assurance Act of 2011," which would apply to federal construction requirements procured using sealed bidding procedures (FAR Parts 14 and 36). I am responding on behalf of Lieutenant General Bostick.

The U.S. Army Corps of Engineers obtains the majority of its construction requirements using competitive negotiations (FAR Parts 15 and 36). Requirements in excess of $1,000,000 procured by the Corps using sealed bidding procedures are typically not very complex and generally do not involve multiple specialized trade subcontractors, e.g., dredging, levee embankment armoring, beach re-nourishment etc. The majority of Corps requirements involving multiple trade subcontractors and procured using sealed bidding are generally less than $1,000,000.

Although the Corps does not comment on proposed legislation, I did want to explain how our contracting process works.

Sincerely,

Steven L. Stockton, P.E.
Director of Civil Works


## SINGLE-PRIME BIDDING BUDGET PROPOSAL

Governor Walker has proposed a modification to how the state procures construction projects that will ensure competitive transparent bidding, as well as a streamlined, more efficient management of these projects.

The organizations and companies listed above, including subcontractors, general contractors and a construction-management firm, support the Governor's proposal.

## BACKGROUND AND PRIORITIES

Wisconsin's current system of contracting for state building projects is broken. While the Department of Administration (DOA) under Governor Walker has greatly improved the process, permanent statutory changes are necessary to help maximize taxpayers' money and avoid the inefficient, costly and unfair bidding practices.

By adopting the proposed method of single-prime contracting as the default delivery method for state building projects, Wisconsin will have a system that will:

**Guarantee Transparency with taxpayer dollars** – By selecting the lowest-responsible qualified bidders in the five major categories of construction. The Governor's proposal takes the politics out of the state building process by focusing on contractor experience and pricing rather than backroom deals. Low-bid and qualifications should be the basis for awarding taxpayer-funded projects.

**Eliminate Bid Shopping** - An open and competitive bid process ensures the lowest cost for the taxpayer and prevents illegal practices like bid shopping. Bid shopping is a practice in which a contractor discloses the bid price of one subcontractor to another in attempt to obtain a lower bid price. Subcontractors also may offer to undercut the known bid of another subcontractor. These practices can occur both before and after a general contractor is selected.

**Save Taxpayer Money** – In addition to reducing the costs of administering its building program, the Governor's proposal is designed to attract the largest possible pool of qualified, pre-certified bidders in each major category of construction. This helps ensure the state is paying the lowest cost for work performed by qualified and responsible contractors.

## SINGLE PRIME CONTRACTING AS DEFAULT DELIVERY METHOD

**Major mechanicals (referred to as MEPF, or mechanical, electrical, plumbing and fire protection contractors) make up the majority of the work on a construction project.**

Under Governor Walker's proposal, the MEPF contractors bid to the state seven (7) days in advance of the general contractors (GC's), thus ensuring a competitive and transparent selection of subcontractors as well as giving the GC's advance notice on which subcontractor companies won the lowest responsible bid.

The GC's then package their bid with the lowest-responsible MEPF contractors in each category and must win overall lowest responsible, qualified bid to the state. This ensures all competitive and transparent bidding for the GC's and MEPF contractors and prevents illegal and unfair practices.

## A BALANCED APPROACH TO MANAGEMENT AND RISK

The GC gains controls of schedule, change orders, and other management of the project, and serves as the single point of contact with the owner. Whether it's the DFD or the University System, a single point of contact will be available to simplify the process. Risk and insurance coverage is addressed by requiring subcontractors to provide separate 100% payment and 100% performance bond. Insurance risk is made clear by ensuring everyone is responsible for their own risk.

## COMPETITIVE BIDDING AND ELIMINATION OF BID-SHOPPING

A bottom line for taxpayer funded construction projects is transparency. In addition to increased costs being paid by the state, bid shopping frequently leads to errors, discrepancies and future disputes between a general contractor and subcontractor.

In a system where $1 billion worth of construction projects are procured by government and funded by taxpayers, our collective position is that no private business should be allowed to pick winners and losers of other private businesses.

We urge your support of Governor Walker's budget provision on single prime bidding.

Michael F. Fabishak
Chief Executive Officer

Associated General Contractors of Greater Milwaukee
Leading the Construction Industry Forward

May 1, 2013

The Honorable Alberta Darling, Co-Chair
Joint Committee on Finance
Room 317 East, State Capitol
P.O. Box 7882
Madison, WI 53707-7882

The Honorable John Nygren, Co-Chair
Joint Committee on Finance
Room 309 East, State Capitol
P.O. Box 8953
Madison, WI 53708

Dear Senator Darling and Representative Nygren:

On behalf of the Associated General Contractors of Greater Milwaukee, I would like to take this opportunity to urge your support for the Governor's single-prime bidding provisions within the 2013-15 state budget, as modified by Secretary Huebsch's April 23rd letter to the Co-Chairs of the Joint Committee on Finance. The Governor's proposal will reduce unnecessary administrative overhead and ensure a more competitive and transparent bidding process.

Eliminating the state's long-ago antiquated multiple-prime project delivery method and replacing it with a single-prime process will provide the following benefits:

1. ***The general contractor*** – rather than the state – will serve as a single point of contact with the state. This will simply the contracting process and eliminate significant Department of Administration and University System overhead.

2. ***Ensure Competition*** by attracting the largest possible pool of qualified, pre-certified bidders in each major category of construction. This competition will ultimately ***save taxpayer dollars*** by lowering costs through a more robust bidding process.

3. ***Requiring a transparent*** bidding process and a more definitive bidding timeline will provide certainty to the state building process, providing all parties with knowledge and certainty when seeking to partner with the State of Wisconsin to deliver projects.

We urge your support of the Governor's proposal to adopt a single-prime contracting process as the state's default delivery method for state building projects.

Please feel free to let me know if you have any questions.

Yours very truly,

Mike Fabishak
Chief Executive Officer

10400 Innovation Drive, Suite 210 * Milwaukee, WI 53226
Phone: 414-778-4100 * Fax: 414-778-4119 * www.agc-gm.org

**DRAFT**
**04-5-13**

# AMENDMENT TO BUDGET BILL (ASSEMBLY BILL 40)

## #1 AMEND SECTION 144:

16.855(9m)(b)2.

c. The bidder is bondable for the term of the proposed contract and can obtain a separate 100% performance and separate 100% payment bond.

k. In any jurisdiction, in the previous 10 years, the bidder has not been disciplined under a professional license and none of the bidder's employees and no member of the bidder's organization has been disciplined under a professional license currently in use.

## #2 AMEND SECTION 146:

16.855 (13) (a) In any project under this section let under single prime contracting, the department shall identify, as provided under par. (c~~b~~), ~~necessary~~ the mechanical, electrical, or plumbing subcontractors who have submitted the lowest bids and are qualified responsible bidders. ~~and a~~ A general prime contractor who is submitting a bid under sub. (14) shall include the ~~selected~~ subcontractors identified under this subsection.

(b) In any project under this section let under s. 13.48(19), the department shall identify, as provided under par. (c), the mechanical, electrical, or plumbing subcontractors who have submitted the lowest bids and are qualified responsible bidders. As directed by the department, the contractor selected by the state and awarded a contract under s. 13.48(19) shall then contract with the mechanical, electrical, or plumbing subcontractors identified as the lowest bidders who are qualified responsible bidders for the mechanical, electrical, or plumbing work under par. (c).

(c~~b~~) For purposes of selecting subcontractors under par. (a) or (b), the department shall develop and administer an open and public bidding process and follow the requirements and procedures under sub. (2). Within 48 hours of the bid deadline under par. (a) or (b) ~~submission~~, the department shall make available on the department Internet site the names of the bidders and the amount of ~~the~~ each bid. No more than 5 ~~7~~ days after the bid deadline ~~for bid submission~~, the department shall post on its website and provide public notice of the lowest bidders who are qualified responsible bidders. The department shall make available on its Internet site the bids, including the bid documents, identified under this paragraph as the lowest bidders and they shall be open to public inspection in accordance with ss. 19.35-19.36. No other bids under this paragraph may be on the Internet site or open to public inspection.

**DRAFT**
**04-05-13**

**#3 AMEND SECTION 148:**

16.855 (14) (am) Except as provided in s. 13.48 (19), the department shall let all construction projects that exceed $185,000 through single prime contracting. The department shall not request or accept any bid alternates when letting a construction project through single prime contracting.

**#4 AMEND SECTION 149:**

16.855 (14) (b) (2) is created to read:
16.855(14) (b) (2) ~~Except as otherwise provided by law, t~~The state shall not be liable for any damages to a subcontractor selected under s.16.855 (13) (a) that enters into a contract with a general prime contractor under s. 16.855 (14) (e).

**#5 AMEND SECTION 150:**

16.855 (14) (bm) If the bid is being let through single prime contracting, bidders for the general prime contractor who are responsible qualified bidders shall submit their bids to the department no later than 5 ~~7~~ days after the successful subcontractor bids become available to the public under sub. (13) (b). Within 48 hours after the bid deadline for general prime contractors, the department shall make the bid tabs identifying the names of the general prime contractors who bid and their bid amounts publicly available on the department's website and, in the event that they are unavailable on the department's website, at the department's offices.

**#6 STRIKE AND REPLACE SECTION 153:**

**(14m) Contracting with MEP Subcontractors.**

(a) Any subcontract entered into between a general prime contractor and subcontractor under sub. (14)(e) or a contract entered into with a MEP subcontractor under sub. 13(b) is void unless it contains all four of the following clauses:

1. Prompt Payment

> [General prime contractor] shall pay [MEP subcontractor] in accordance with s. 16.855(19)(b) for work that has been satisfactorily completed and properly invoiced by [MEP subcontractor]. A payment is timely if it is mailed, delivered or transferred to [MEP subcontractor] by the deadline set forth in s. 16.855(19)(b).
>
> If [MEP subcontractor] is not paid by the deadline set forth in this subcontract, [general prime contractor] shall pay interest on the balance due from the eighth day after [general prime contractor's] receipt of payment from the Department of

Administration for the work for which payment is due and owing to [MEP subcontractor], at the rate specified in Wis. Stat. § 71.82(1)(a) compounded monthly.

[MEP subcontractor] receiving payment under this section shall pay lower-tier subcontractors, and be liable for interest on late payments, in the same manner as [general prime contractor] is required to pay [MEP subcontractor].

2. Insurance and Bonds

[MEP subcontractor] shall not commence work under this contract until it has obtained all necessary insurance required of [MEP subcontractor] in [general prime contractor's] contract with the Department of Administration.

[MEP subcontractor] shall provide a separate 100% performance bond and a separate 100% payment bond to the benefit of the general prime contractor as the sole named obligee. Original bonds shall be given to the general prime contractor and a copy shall be given to the department no later than 10 days after execution of this subcontract.

3. Indemnification

To the fullest extent permitted by law, [MEP subcontractor] shall defend, indemnify and hold harmless [general prime contractor] and its officers, directors, agents, and any others whom [general prime contractor] is required to indemnify under its contract with the department, and the employees of any of them, from and against claims, damages, fines, penalties, losses and expenses, including but not limited to attorneys' fees, arising in any way out of or resulting from the performance of the work under this agreement, but only to the extent such claim, damage, fine, penalty, loss or expense: (1) is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of property, including but not limited to loss of use resulting therefrom and is caused by the negligence of or acts or omissions of [MEP subcontractor], its sub-subcontractors, any of their employees and anyone directly or indirectly employed by them or anyone for whose acts they may be liable, or (2) as related to such claims, damages, fines, penalties, losses and expense of or against the [general prime contractor], results from or arises out of [general prime contractor]'s negligence or other fault in providing general supervision or oversight of [MEP subcontractor]'s work, or (3) as related to such claims, damages, fines, penalties, losses and expense against the department, arises out of the department's status as owner of the project or project site.

In addition, [MEP subcontractor] shall defend, indemnify and hold harmless [general prime contractor] and its officers, directors, agents, and any others whom [general prime contractor] is required to indemnify under its contract with the department, and the employees of any of them, from any liability (including

liability resulting from a violation of any applicable safe place act) that [general prime contractor] or the state incurs to any employee of [MEP subcontractor] or any third party where the liability arises from a derivative claim from said employee, when such liability arises out of the [general prime contractor's] or the state's failure to properly supervise, inspect, or approve [MEP's subcontractor's] work or work area, but only to the extent that such liability arises out of the acts or omissions of [MEP subcontractor], its employees, or anyone for whom [MEP subcontractor] may be liable, or from [MEP subcontractor's] breach of its contractual responsibilities or arises out of [general prime contractor]'s negligence or other fault in providing general supervision or oversight of [MEP subcontractor]'s work or arises out of the department's status as owner of the project or project site. In claims against [general prime contractor] or the state by an employee of the [MEP subcontractor] or its subcontractors or anyone for whose acts [MEP subcontractor] may be liable, the indemnification obligation of this paragraph shall not be limited by a limitation on amount or type of damage, compensation, or other benefits payable by or for the [MEP subcontractor] or its subcontractors under workers' compensation act.

Except as identified above in this section, the obligations of [MEP subcontractor] under this indemnification shall not extend to the liability of [general prime contractor] and its agents or employees thereof arising out of (1) preparation or approval of maps, drawings, opinions, reports, surveys, change orders, designs or specifications; (2) the giving of or failure to give directions or instructions by the [general prime contractor] or the department or their agents or employees thereof provided such giving or failure to give is the cause of the injury or damage; or (3) the acts or omissions of other subcontractors.

4. Retainage

Retainage shall occur and be in amounts and on a schedule equal to that in [general prime contractor's] contract with the Department of Administration.

(b) Any subcontract entered into between a general prime contractor and subcontractor under sub. (14)(e) must include a scope of work clause that is identical to that on which the subcontractor bid under sub. (13).

(c) A general prime contractor and subcontractor under sub. (13)(a) are prohibited from entering into any other agreements in connection with bids submitted under subs. (13) or (14) that would somehow alter or affect the scope or price of the contract or subcontract except for 1.) any change orders by the department that result in changes to the plans or specifications or 2.) any backcharges allowed by the subcontract.

(d) When the building commission approves an alternative delivery method under s. 13.48(19), a contractor shall be subject to the requirements in this section except for sub. par. (14m)(e) when working with any mechanical, electrical, or plumbing subcontractors.

(e) Unless otherwise agreed to by the mechanical, electrical and plumbing subcontractors, the general prime contractor shall base its project schedule on the duration set forth in the project specifications or bid instructions.

## #7 AMEND SECTION 152:

16.855 (14) (e) Within 30 days after the deadline under par. (bm), the department shall ~~notify~~ identify the ~~successful~~ general prime contractor who was selected consistent with 16.855 (14) (d) and then notify this successful general prime contractor of its selection. The contractor who is awarded the contract shall enter into contracts with the mechanical, electrical, or plumbing subcontractors selected under par. (13) (a) and shall comply with the requirements under sub. (14m). The department shall make the final bid results available on its Internet site at the time it provides the written, official notice to the successful general prime contractor bidder notifying the contractor that the contract is fully executed and that the contractor is authorized to begin work on the project.

## #8 AMEND SECTION 155:

16.855 (19) (b) As the work progresses under any subcontract under sub. (14) (e) for construction of a project, the general prime contractor shall, upon request of a subcontractor, pay to the subcontractor an amount equal to the proportionate value of the subcontractor's work properly completed ~~done~~, less retainage. The retainage shall be an amount equal to not more than 5 percent of the subcontractor's work completed until 50 percent of the subcontractor's work has been completed. At 50 percent completion, no additional amounts may be retained, and partial payments shall be made in full to the subcontractor unless the department certifies that the subcontractor's work is not proceeding satisfactorily. At 50 percent completion or any time thereafter when the progress of the subcontractor's work is not satisfactory, additional amounts may be retained but the total retainage may not be more than 10 percent of the value of the work completed. Upon substantial completion of the subcontractor's work, any amount retained shall be paid to the subcontractor, less the value of any required corrective work or uncompleted work. All payments the general prime contractor makes under this paragraph shall be within 7 calendar days after the date on which the general prime contractor receives payment from the department for the same ~~work performed~~.

## #9 STRIKE SECTION 9101.

# Construction owners charged with extorting employees

Jane M. Von Bergen, *Inquirer Staff Writer*
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Two construction executives conspired to force their employees to pay kickbacks to keep their jobs at a Fort Dix reconstruction project and then also conspired to falsify wage records, according to an indictment unsealed in federal court in Camden on Tuesday.

Leonard Santos, 66, of Yardley, owner of Sands Mechanical Inc. in Bristol, and Alex Rabinovich, 57, of Richboro, the company's general manager, pleaded not guilty before U.S. Magistrate Judge Ann Marie Donio.

Meanwhile, federal investigators combed through Sands' offices, according to Santos' attorney, Joel D. Rosen of West Windsor, N.J.

"No [kickback] money came to him," Rosen said.

He said other Sands employees may have "tried to put the squeeze on their fellow employees" without Santos' knowledge.

From November 2009 to September 2010, Sands was a subcontractor responsible for sheet metal, electrical, and plumbing work needed to restore the Marine Corps Training Center at Joint Base McGuire-Dix-Lakehurst.

In court Tuesday, Santos also was charged with orchestrating a campaign to intimidate and injure the site manager for the general contractor at the Dix project because the manager challenged the quality of Sands' work.

The manager had also threatened to stop payments until Sands paid its employees money he said they were due, according to the indictment.

On May, 17, 2010, the manager's Ford Ranger pickup was torched. Three weeks later, on June 10, the manager was struck by a vehicle as he approached his Burlington County home on a bicycle, according to federal documents.

The investigation has led to the arrest and conviction of seven coconspirators, including Santos' son-in-law. Charges include arson, aggravated assault, and collecting kickbacks.

The 21-page indictment unsealed Tuesday describes a workplace full of corruption.

"As a practice, employees were told they had to kick back $10 an hour," Assistant U.S. Attorney V. Grady O'Malley said. "That's the way business was done."

The job site came under scrutiny when Local 27 of the Sheet Metal Workers International Association learned that workers were not being paid the industry standard wage, as required by law for federal construction projects.

The U.S. Department of Labor investigated and ordered that the workers receive back pay. Eventually, they were paid settlements for the higher wages. Individual settlements ranged from $307 to $10,768.

But, according to the indictment, they weren't allowed to cash those checks.

Instead, intimidated by threats of violence, they had to sign their checks over to Santos' son-in-law and another man who worked for Sands. Both are among the seven who have pleaded guilty.

Santos and Rabinovich also were accused of conspiring to pay a separate general contractor's representative in order to get other federal construction work, the indictment said.

To do that, they allegedly agreed to pay $46,200 in cash to the representative, whose job it was to handle subcontractors' bids.

In return for the cash, the representative allegedly let Santos and Rabinovich have a look at what were supposed to be blind bids, allowing them to undercut the low bidder. As a result, the indictment said, Sands landed 13 federal contracts from October 2009 to January 2013.

The two men are free pending trial on May 28.

**Statement of**

# THE SURETY & FIDELITY ASSOCIATION OF AMERICA

**Subcommittee on Contracting and the Workforce**
**U.S. House Committee on Small Business**


**May 24, 2013**

**1101 Connecticut Ave., NW, Suite 800**
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The Surety & Fidelity Association of America (SFAA) is a District of Columbia non-profit corporation whose members are engaged in the business of suretyship. SFAA member companies collectively write the majority of surety and fidelity bonds in the United States. The SFAA is licensed as a rating or advisory organization in all states, as well as in the District of Columbia and Puerto Rico, and it has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety data.

**H.R. 776 is a key tool in eliminating fraud, increasing the effectiveness of federal procurement and helping small contractors obtain government contracts**

Every contractor that bids and obtains a federal construction contract must secure its obligations under that contract. The most common form of security is a surety bond from a surety insurance company.

Over the years what originally may have been a viable option to a surety bond for securing obligations to the federal government has not kept up with the changes in federal procurement and the economy. H.R. 776 would ensure that all security pledged to the federal government to secure an obligation is functionally equivalent, whether such assets pledged in lieu of a corporate surety are from the contractor or an individual surety on behalf of the contractor.

Likewise, since the early 1970s, the Small Business Administration has operated its Surety Guarantee Program (SBA Bond Program) to assist small and emerging contractors obtain bonding in order to be able to bid on federal construction projects. This has been especially true in times of economic downturn when bonding sometimes becomes more scarce and difficult to obtain. This program needs updating to keep up with the changes in procurement. H.R. 776 would increase the maximum bond guarantee from the SBA Bond Program to the sureties from 70% to 90% in the Preferred Surety Program. This will help the SBA Bond Program to reach its full potential in this new economy.

**Background on Individual Sureties in the Federal Procurement Process**

Under current federal law and regulations, construction contractors for the federal government have three options for securing their obligations. They can obtain a surety bond from an insurance company that is vetted and approved by the U.S. Department of Treasury and licensed by a state insurance regulator. In lieu of a bond, contractors can pledge and deposit assets with the federal government until the contract is complete. Only assets backed by the federal government can be pledged. The third option permits individuals to pledge their assets to back the contractor. These individuals are called "individual sureties." Only individual sureties are permitted to pledge assets not backed by the federal government. In fact, individual sureties are allowed to pledge stocks, bonds, and real property, and also are not required to deposit such assets with the federal government for the duration of the contract.

All individual sureties need to give federal contracting officers is a document listing the assets and their value and representing that theya re pledged in an escrow account to secure the contractor's obligations.

The original concept of an individual surety was a person with sufficient wealth that was willing to pledge his/her assets as security to the federal government if the contractor was awarded a federal construction project. Such individual sureties knew the contractor that they were backing personally. The individual surety many times was relative or close acquaintance of the contractor. All the individual surety needed to do was provide a sworn affidavit, verified by another party, that his or her net worth was sufficient to cover the contractor's bond obligations.

As the economy developed, the vast majority of bonds were provided by corporate insurers, and people who were providing individual surety bonds based on sworn affidavits began to do so for profit. They were individuals who were in the business of being an individual surety and were unknown or unrelated to the contractor providing the bond. Increasingly, the affidavits of such individual sureties were backed by insufficient and illusory assets and claims on the bond went unpaid. In 1990, the Federal Acquisition Regulation (FAR) was amended in an attempt to correct these abuses. The FAR now requires that individual sureties pledge specific assets in an escrow account at a federally insured financial institution equal to the penal amount of the bond. The affidavit that individual sureties now provide must include a specific description of the assets pledged, and represent that they are not pledged for other bonds. These rules, however, have not solved the problem of illusory and insufficient assets.

**Why H.R. 776 is Needed Now**

The individual surety concept has evolved over time from an uncompensated individual who was known to the contractor into an independent third party who agrees to post assets for the contractor for profit. While it may have made sense decades ago to permit individual sureties to post a variety of assets—real estate, stocks, bonds—it no longer makes sense in the current context of individual sureties as persons unknown to the contractor who pledge assets that are often non-existent or hard to value, fluctuate in value or are impossible to liquidate to pay claims. As noted above, in 1990, the FAR was amended to tighten the requirements for assets pledged by individual sureties in response to fraud. Those amendments did not solve the problem. The assets that individual sureties can pledge to the federal government continue to be problematic.

Contracting officers today cannot enforce the existing requirements. They are presented lists of assets pledged that include assets that are not in an escrow account, are hard to verify, hard to value, that fluctuate in value, and that would be hard to liquidate if needed upon default. It is often difficult to determine whether the individual surety actually owns the assets, and whether the individual surety is pledging the assets for just the project in ques-

tion or whether the same assets have been pledged for many projects in different federal agencies. This remains a significant problem in federal construction projects.

After one individual surety filed for bankruptcy and the United States asked the court to declare his debts to it non dischargeable, the court found, "The Debtor knew that he was pledging the same properties as bond collateral multiple times, and yet he patently denied doing so on each Affidavit . . . the Debtor repeatedly pledged property he did not own in support of his surety bonds . . . Moreover the Debtor made those false statements in order to induce the United States to accept him as a surety." (*United States v. Sears (In re Sears),* Case No. 09–11053, Adv.Proc.No. 09–1070 (Bankr.S.D.Ala. February 16, 2012)).

Under H.R. 776 federal contracting officers no longer will have to attempt to determine whether the assets that individual sureties pledge exist, are owned by the individual surety, and are worth the actual value claimed. Just like the assets that the contractor must pledge, the assets that individual sureties pledge will have to be eligible obligations as determined by the US Treasury, and handed over to the federal government and held and scrutinized in the same manner.

**Why Congress Should Act Now**

The general contractor on federal construction projects is required to provide performance and payment bonds for the protection of the taxpayers and subcontractors, suppliers and workers on the job. If the general contractor's bonds are backed by supposed assets of an individual surety that in fact do not exist, are difficult to verify, or are not readily convertible into cash to pay the obligations of the general contractor in case of default, everyone on the project is left unprotected. Experience has shown that if the assets pledged are uncollectible, subcontractors, suppliers, and workers on the job are left with no payment remedy if the contractor fails to pay them. These potential claimants cannot place a lien on public property or seek redress from the federal government for not obtaining a meaningful bond. The federal government is left with unfunded expenses to complete the construction projects and the persons who furnished labor and materials are left unpaid.

For example, see judgments entered in *U.S. for the use of Fuller v. Zoucha,* C.A. No. 2:05–cv–325 (E.D. Cal.); *U.S. for the use of Norshild Security Products LLC v. Scarborough,* C.A. No. 8:09–cv–1349 (D. Md.); and *United States v. Sears (In re Sears),* Case No. 09–11053, Adv.Proc.No. 09–1070 (Bankr.S.D.Ala. February 16, 2012).

Under federal law and regulations, a contractor pledging assets directly to the federal government is subject to far more stringent rules than an individual, acting for profit, who pledges his or her own assets to back the contractor for a fee.

Major contracting groups support H.R. 776 because it would create clarity and certainty in any collateral given to the federal government. There would be either a surety bond from a croporate surety vetted by the U.S. Treasury Department to do business with

the federal government and licensed by a state regulator, or collateral provided to the designee of the Secretary of the Treasury by a contractor or individual surety in a readily identifiable form and value. All such collateral would be deposited with and vetted by the designee of the Secretary of the Treasury (currently the Federal Reserve Bank of St. Louis).

The uncertainty of the current system increases the cost to the federal government. First, individual sureties charge more for bonding than corporate sureties. Corporate surety rates are regulated by state regulators. No one regulates individual sureties. Second, if a contracting officer rejects an individual surety bond the resulting bid protest is costly and delays the project. Of course there also is the cost of attempting to track down and liquidate an asset if a claim must be made on the bond. This holds true for claimants under the payment bonds as well.

Individuals and small businesses working on a federal construction project—either as subcontractors, suppliers, or workers on the job—have no control over the general contractor's choice of security provided to the federal government, but they suffer the most harm financially if the provided security proves illusory. The result of H.R. 776 is that laborers, subcontractors, and suppliers on federal construction projects will know that adequate and reliable security is in place to guarantee that they will be paid.

**Why H.R. 776 Makes Sense**

H.R. 776 is just common sense. The security that stands behind every federal contractor's obligations to the federal government should be governed by the same rules. There should be either a corporate surety bond in place from a company approved by the U.S. Treasury and licensed by a state regulator, or assets with readily identifiable value pledged and relinquished to the federal government while the construction project is ongoing. The same rules should apply to the individual sureties that apply to any federal contractor that is securing obligations to the federal government.

It does not make sense to permit an individual surety to post collateral that the contractor could not post on its own behalf. H.R. 776 would require the collateral that the contractor can post and that the individual surety can post on its behalf, to be equivalent. If individual sureties have the assets they claim, they could easily provide U.S. debt obligations and turn them over to the contracting officer for deposit for the duration of the construction project. The individual would earn interest on that obligation while it is in the custody of the federal government.

H.R. 776 makes the government procurement process more effective and efficient in a way that saves government resources and taxpayer dollars, reduces fraud, and will have no additional costs.

**Background on the SBA Surety Bond Guarantee Program**

The SBA Bond Program provides surety bond companies with partial repayment of losses from bonds that they would not ordinarily write for less qualified small and emerging contractors. The

purpose of the SBA Bond Program is to obtain surety bonds for small and emerging contractors so that they can develop a track record of success. As these contractors grow and establish themselves, they can already have a relationship with a surety company. This surety company then can provide the bonds they need as government contractors, either with or without the SBA's bond guarantee. The goal of the SBA Bond Program is to graduate contractors into the standard surety market, making the SBA bond guarantee funds available for new small and emerging contractors.

It is essential to understand why this is important. For most public construction projects, contractors are required to provide surety bonds to the government. These bonds guaranty that the contractor will perform the work and will pay the subcontractors, suppliers and workers on the project. Since the surety will be required to pay if the contractor cannot perform its contract and pay its bills, a surety carefully examines the contractor's capability, experience and financial situation when determining whether or not to put its own financial wherewithal behind the contractor. Establishing a track record and building capital is a challenge for small and emerging contractors. Therefore, in order to assist these small businesses to obtain work on public projects, the federal government determined that it would act as a reinsurer for sureties willing to write bonds for these contractors.

As the SBA Bond Guarantee Program has evolved, there are two plans under which sureties can participate in the Program. The Prior Approval Program (Plan A) was the original SBA bond guaranty program. In this program, the surety must obtain SBA approval for each bond prior to writing the SBA guaranteed bond. The SBA maximum indemnification of the surety's loss as a result of a bond claim in Plan A is 80%, and 90% for bonds written for socially and economically disadvantaged contractors and bonds written for contracts under $100,000. The second program is the Preferred Surety Bond Program (Plan B). Under this plan, sureties apply to participate, submitting information up front on their underwriting practices and financial strength. Once a surety becomes a participant in Plan B, it is given an aggregate limit of bonds that it can write within the Program. As long as the surety complies with all of the requirements of Plan B, all bonds written within the Program qualify for reimbursement of losses. The SBA does not review or approve each individual bond before it is written and the guarantee attaches. In Plan B the surety receives a maximum 70% indemnification.

**Why H.R. 776 is Needed**

Over the years, surety participation in the SBA Bond Guarantee Program has ebbed and flowed. One primary driver is the economy, which includes the profitability of the surety industry and the appetite for bonding small and emerging contractors. The SBA's current data shows that most of the bonds it guarantees comes from the Prior Approval Program, which has the higher bond guarantee. In the past in better economic times, the Preferred Surety Program accounted for over 50% of SBA Bond Program's premiums, which

now is less than 15%. In this economy, taking this additional risk for such a low guarantee is not fiscally sound.

Another factor of change in participation in the SBA Bond Program is the administration of the program. Increases in the SBA's fees to sureties for participation and some internal problems have discouraged some sureties from participation in the SBA Bond Program, and caused others that do still participate to limit their participation. In recent years, however, the SBA has undertaken incremental efforts to improve the functioning and the appeal of the Program, such as improving its application process and procedures, its response time to claims and expanding the Program's reach to include design-build contracts. Most recently, the SBA announced a rule to fast track bonding applications for $250,000 or less. The bottom line still is that the SBA Bond Program no longer makes financial sense to many sureties.

The examples of the increases in the SBA's loan programs for small businesses demonstrates that the increase in the maximum SBA bond guarantee under H.R. 776 would go a long way in making participation in the SBA Preferred Surety Program more attractive again. In the 111th Congress, the SBA's appropriations bill included $125 million to continue enhancements made to the SBA's 7(a) and 504 loan programs in February 2009. The SBA was allowed to eliminate fees on 7(a) and 504 loans, the maximum government guarantee to banks that make these loans was increased to 95% and the maximum loan that could be guaranteed was increased from $2 million to $5 million. These enhancements to the loan program led to an immediate nationwide increase in lending.

In June 2010, the SBA reported that its weekly dollar volume of SBA-backed loans had risen 90% in its 7(a) and 504 loan programs during the period of Feburary 17, 2009, until April 23, 2010. In October 2011, SBA reported that in fiscal year 2011, the SBA supported $30.5 billion (61,789 loans), a return to pre-recession levels.

It is clear that an increase in the guarantee amount and the reduction or waiver of fees increases participation in government guarantee programs. Such reforms should be implemented in the SBA Bond Program to provide a boost to the bonding program.

**Why Congress Needs to Act Now**

The SAA believes that the SBA Bond Program is vital to the growth of small and emerging contractors in America. One, well-run Surety Bond Program assures consistency of participation requirements and administrative procedures. Without the SBA Bond Program, many federal agencies may initiate their own program to assist small and emerging contractors. Some already have done so. States also have begun this process. Duplicative efforts among federal and state agencies waste time and resources that should instead be used to help small businesses.

Congress has and continues to express its support for the SBA Bond Program. After Hurricane Katrina, Congress first looked at temporary increases in the maximum amount of the bond that SFAA is permitted to guarantee. The SBA's maximum bond guar-

antee was increased for two years under the American Recovery and Reinvestment Act of 2009. Just last year, Congress enacted legislation that permanently raises the maximum amount of the bond that the SBA can guarantee from $2 million to $6.5 million and prevents the SBA from unraveling bond guarantees made with the SBA's prior approval. Another new provision permits the SBA to guarantee a bond up to $10 million if a contracting officer of a federal agency certified that such a bond guarantee is necessary.

The President also recently issued a waiver from rescission from the unobligated funds from the American Recovery and Reinvestment Act (ARRA) for certain programs, including the SBA Bond Guarantee Program. Currently, $15 million in funding remains unobligated for the Surety Bond Guarantees Revolving Fund. The amount will remain in the Program. The President's order states that the retention of these unobligated balances will allow the executive agencies to continue to execute projects vital to the national interest in a fiscally responsible manner.

Enactment of H.R. 776 is another logical and necessary step in the process towards the SBA Bond Program reaching its potential.

**Why H.R. 776 Makes Sense**

H.R. 776 would enhance the SBA Bond Program just the way the SBA loan programs were enhanced when needed in the economic downturn. This can be done right now for the SBA Bond Program with no additional cost. It does not make sense that the SBA Bond Program should be operating at less than full capacity now, at a time when small and engineering contractors need help all the more. Congress has acted to assist small and emerging contractor obtain the needed loans for construction projects and it only makes sense to enhance the SBA Bond Program to assist them in like manner with the required bonding as well.

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