

RECORD VERSION

**STATEMENT BY
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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**

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**NOT FOR PUBLICATION UNTIL RELEASED BY THE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 or 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 investigate 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.