Statement of

Randall D. Gibson of Whitesell-Green, Inc.

on behalf of

The Associated General Contractors of America

to the

U.S. House of Representatives

House Committee on Small Business

For a hearing on

"Contracting and the Industrial Base"

February 12, 2015

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 25,000 firms, including America's leading general contractors and specialty-contracting firms. Many of the nation's 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.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
2300 Wilson Boulevard, Suite 300 • Arlington, VA 22201 • Phone: (703) 548-3118 • FAX: (703) 548-3119

Statement of Randall D. Gibson
Whitesell-Green, Inc.; Pensacola, Florida
House Committee on Small Business
United States House of Representatives
February 12, 2015

Chairman Chabot, Ranking Member Velázquez and members of the Committee, thank you for inviting the Associated General Contractors of America (AGC)—of which I am a member—to testify on reforms to the federal government's contracting laws relating to the industrial base, including the construction industry.

My name is Randy Gibson. I am president of Whitesell-Green, Inc. (WGI)—a small business construction contracting firm based in Pensacola, Florida that services the Southeast region. Since WGI's founding in 1970, we have constructed over 400 heavy/commercial projects—public and private—resulting in nearly one billion dollars of completed contracts. On the federal government side, WGI has completed numerous projects for the U.S. Army Corps of Engineers, Naval Facilities Engineering Command, the Air Force Civil Engineer Center, and Department of Veterans Affairs.

Today, I will discuss the need for Congress to:

I. Prohibit all federal agencies from procuring construction services through reverse auctions;

II. Reform design-build contracting government-wide;

III. Encourage sensible consideration of past performance records in the joint venture and teaming context;

IV. Prevent unintended consequences of misinterpretation of the nonmanufacturer rule; and

V. Help prevent fraud in the surety bond market;

I. Prohibit All Federal Agencies from Procuring Construction Services through Reverse Auctions

AGC strongly supports full and open competition for contracts necessary to construct improvements to real property. This includes competition among general contractors, specialty contractors, suppliers and service providers. Over the years, it has been established that such competition energizes and improves the construction industry to the benefit of the industry and the nation as a whole, especially taxpayers. As Congress considers changing the federal procurement landscape, we offer the following points for consideration during your evaluation of reverse auctions.

a. The Problems with Reverse Auctions for Construction Services Contracts and How Reverse Auctions Limit Competition

i. Reverse Auctions Do Not Provide Benefits Comparable to Currently Recognized Selection Procedures for Construction Contractors

Vendors promoting online reverse auctions are selling technology for which there may be legitimate economic justifications for some types of procurements. However, those vendors have neither presented persuasive evidence that reverse auctions generate real savings in the procurement of the design or construction of a project, nor have they adequately explained how reverse auctions generate the benefits of "best value" comparable to currently recognized selection procedures for design and construction contractors. Such selection procedures have been carefully tailored to meet industry standards that generate competitive procurements for the benefit of taxpayers. In fact, reverse auction vendors have said themselves that reverse auctions for design and construction services are not appropriate. [1]

Unlike manufactured goods and commodities—i.e., pens, paper, so forth—construction services are project-specific and inherently variable. Each construction services contract is subject to the unique demands of the project, including: the geography—including but not limited to site conditions, the seasonality of certain construction activities, project proximity to major suppliers, and site ingress and egress in conjunction with other landowners—the needs, requirements, personnel and budgetary criteria of the owner, specific and unique design features, construction requirements 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 promoting reverse auctions for construction services misuse a procurement process originally established for commodities and ignore the unique nature of construction. Designers, 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.

ii. 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 successively lower bids as the auction progresses. As a result, a bidder has no incentive to offer its best price and subsequently may never offer its lowest price—as opposed to during low price technically acceptable procurements and other contracting approaches. In addition, savings from reverse auctions can be one time occurrences.

[1] Joe Jordan, former Office of Federal Procurement Policy Administrator and now FedBid reverse auction company employee, has noted that reverse auctions are not appropriate for procuring design and construction services. James Best, Jr., *Reverse Auctions Draw Scrutiny*, NEW YORK TIMES, April 6, 2014 *available at:* http://www.nytimes.com/2014/04/07/business/reverse-auctions-draw-scrutiny.html?_r=0.

iii. Reverse Auctions 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 can move too quickly for competitors to accurately assess 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: designers, prime contractors, subcontractors, sureties and especially federal agencies. For prime construction businesses, imprudent bidding can lead to project default. In the case of subcontractors, imprudent bidding means they may be pushed to unrealistically lower their prices, which will jeopardize the quality of the supplies, materials and services those subcontractors can provide. The risk of and actual default can increase surety bond costs. All these problems have the effect of increasing the ultimate cost of construction as well as the cost of operating and maintaining the facility to the federal agency and the taxpayer.

During reverse auctions, small construction businesses are most likely to fall victim to such imprudent bidding and experience the greatest harm. Small construction businesses have less cash flow and reduced ability to handle risk than non-small construction businesses. Some small business contractors may simply bid a job below cost to maintain some form of cash flow to remain in business. Additionally, some may fall victim to the auction's time restraints and consequent knowledge gap. Under pressure to win the job, a small business may unwittingly underbid, thinking that the subcontractors it has lined up would perform at that low of a price. Unable to have subcontractors perform the work, the prime small business may not have the capability to actually perform all of the work on its own and default. And, to add insult to injury, the federal government can even file a claim against the contractor when it underbids a contract under the False Claims Act.[2]

iv. Reverse Auctions Do Not Allow Thorough Evaluation of Value, Unlike Negotiated Procurements

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 project needs. These processes recognize the value and quality of project relationships that share expertise to 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 also offers both the owner and contractor the opportunity to discuss and to clarify performance requirements of the project.

[2] In the case of *Hooper v. Lockheed Martin Corp*., the U.S. Court of Appeals for the Ninth Circuit ruled for the first time that underbidding or making false estimates in bids or proposals submitted in response to federal government solicitations may constitute violations of the False Claims Act. In a situation where a bidder needs a contract to maintain cash flow, the reverse auction can serve as an easy way for some contractors to do that. However, as this case reflects, there can now be legal liability for doing so that could further endanger the company. For more information see http://www.mckennalong.com/media/site_files/1979_FCA%20Article.pdf

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, scheduling, long-term maintenance and unique needs, are deemphasized in the auction. As a result, reverse auctions do not offer owners a sufficient opportunity to evaluate non-price factors.

v. 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 proposer offers its best price and bids are 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 laws, regulations and years of precedent that address critical factors and ensure the integrity of the process.

vi. Reverse Auctions Limit Competition

My company—as well as many AGC members of all sizes—choose not to participate in reverse auctions for all of their risks and faults articulated above. Again, AGC strongly supports full and open competition for contracts necessary to construct improvements to real property. We contend that reverse auctions create an environment where competition is unnecessarily limited to the detriment of the federal government and taxpayers. In fact, we contend that no objective study on the issue has provided persuasive evidence that reverse auctions generate the cost, or best value for the procurement of construction services.

b. Federal Agency Experience, Reports and Policy on Reverse Auctions

Federal agency experience and reports support AGC's position that Congress should prohibit reverse auctions for design and construction services contracts. Those sources include the U.S. Army Corps of Engineers, the White House Office of Federal Procurement Policy, and the Government Accountability Office.

i. The U.S. Army Corps of Engineers' Experience & Findings

The U.S. Army Corps of Engineers (USACE) published a 2004 study entitled "Final Report Regarding the U.S. Army Corps of Engineers Pilot Program on Reverse Auctioning."[3] The

[3] U.S. ARMY CORPS OF ENGINEERS, FINAL REPORT REGARDING THE U.S. ARMY CORPS OF ENGINEERS PILOT PROGRAM ON REVERSE AUCTIONING, 2004 *available at:* http://docs.house.gov/meetings/VR/VR08/20131211/101557/HHRG-113-VR08-Wstate-CaryN-20131211.pdf

report determined that although reverse auctioning had potential in the purchase of "simple commodities" where variability is exceedingly small or nil (identical products under identical conditions), its use for the purchase of construction services where the dynamics and variables are just too diverse "should be the very rare exception and not the rule – if used at all." The USACE report further states that on the rare occasion reverse auctioning may be considered as an acquisition method, such consideration should only be made after sealed bidding has failed.

On March 6, 2008, Major General Ronald L. Johnson, former Deputy Commanding General of USACE, testified before the House Committee on Small Business on this very issue. MG Johnson testified that "[t]he 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."

Most recently, on May 23, 2013, USACE Engineering and Construction Chief James C. Dalton, P.E., also testified before the House Committee on Small Business on a similar topic. Mr. Dalton noted that reverse auction procurement "provides a benefit when commodities or manufactured goods procured are of a controlled and consistent nature with little or no variability. Construction is not a commodity." He went on to state that "procuring construction by reverse auction neither ensures a fair and reasonable price nor a selection of the most qualified contractors." As a result of its experiences, USACE does not procure construction services using reverse auction procurement.

ii. White House Office of Federal Procurement Policy Findings

Furthermore, the federal government has elsewhere acknowledged that construction services stand apart from commodities or manufactured goods. In a July 3, 2003, memorandum from Office of Federal Procurement Policy Administrator Angela Styles, the government states that "[n]ew 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 to encourage them not to treat construction as a commodity for government procurement purposes.

iii. Government Accountability Office

In December 2013, the Government Accountability Office issued a report[4] that reviewed reverse auction procurement in four agencies: the Army, Department of Homeland Security, Department of the Interior, and the Department of Veterans Affairs. The report notes that reverse auction procurement increased over 175 percent between fiscal years 2008 and 2012 and that agency officials are increasingly using reverse auctions to acquire services and for more complex contracting actions.

[4] GOVERNMENT ACCOUNTIBILTY OFFICE, REVERSE AUCTIONS: GUIDANCE IS NEEDED TO MAXIMIZE COMPETITION AND ACHIEVE COST SAVINGS, DEC. 2013 *available at* http://www.gao.gov/products/GAO-14-108.

Furthermore, the report finds that agencies have awarded a significant number of contracts when there was only one bidder or a lack of interactive bidding. Specifically, the selected agencies conducted 3,617 reverse auctions where only one vendor participated and submitted one bid. Agencies paid $1.7 million in fees for these auctions and were unlikely receiving the best price, as there was no competition. And, counter to the claims of reverse auction vendors, the GAO report finds that "it is unclear whether savings due to reverse auctions are accurate because target prices may be set too low or too high."

c. Reverse Auctions in the Department of Veterans Affairs and the General Services Administration

Over the years since USACE's first-hand insight on reverse auction procurement of construction services, AGC has found that some agencies—including the Department of Veterans Affairs (VA) and the General Services Administration (GSA)—continue to use or push this acquisition tool for construction. By no means are these two agencies alone. AGC has also brought the inappropriate use of reverse auctions to the attention of the National Parks Service and other agencies within the Department of Interior. For the purposes of today's hearing, we will address our concerns with the VA and GSA.

i. Department of Veterans Affairs

The VA construction program separates into two appropriation accounts: (1) minor construction, for projects of $10 million or less; and (2) major construction, for projects over $10 million. Similarly, the VA structures its construction program into two organizations, one where the 22 regional Veterans Integrated Services Network (VISNs) offices procure minor construction contracts and the other in the Office of Construction and Facilities Management (CFM) that handles major construction contracts.

In AGC's experience, the inappropriate use of reverse auction rests with the VISNs and not with CFM. AGC has tried to reach out to VISNs that utilize this acquisition tool to inform them of prior federal agency experience and the inherent risks they bring. However, they have not been responsive. As such, AGC reached out to CFM about minor construction project awards procured through the reverse auction process since 2011. Those awards included the following 14 examples:

1. VA261-13-B-0854, Renovation Support – Facility Space Realignment, San Francisco VA Medical Center, California; Award: $888,508.80
2. VA247-13-R-1355, Floor Maintenance and Repair, Central Alabama Veterans Health Care System (CAVHCS), Montgomery and Tuskegee, Alabama; Award: $727,924.10
3. VA247-13-Q-1567, Place Ductwork and Equipment, Atlanta VA Medical Center, Decatur, Georgia; Award: $283,250.00
4. VA247-13-B-1655, Auditorium Upgrades, Ralph H. Johnson VA Medical Center, Charleston, South Carolina; Award: $224,540.00
5. VA2417-13-R-0228, Stairwell Repairs, Carl Vinson VA Medical Center, Dublin, Georgia; Award: $208,352.52

6. VA247-13-R-1560, Fall Protection Installation, Atlanta VA Medical Center, Decatur, Georgia; Award: $101,053.30
7. VA262-12-Q-0950, Construct Concrete Slab Parking Pad with Security Fence, VA Medical Center, North Las Vegas, Nevada; Award: $86,700.66
8. VA262-13-Q-0514, Install/Replace Flooring, VA Medical Center, North Las Vegas, Nevada; Award: $82,297
9. VA247-12-R-1390, Floor Restoration Building 802, Charlie Norwood VA Medical Center in Augusta, Georgia; Award: $81,267.00
10. 542-11-4-5306-0076, Retaining Wall Repair, VA Medical Center, Coatesville, Pennsylvania; Award: $75,639.08
11. VA247-12-R-1396, Floor Restoration, Charlie Norwood VA Medical Center in Augusta, Georgia; Award: $52,009.85
12. VA247-13-Q-1348, Medical Air Compressor Installation, VA Medical Center, Fort McPherson, Georgia; Award: $51,685.40
13. 561-13-4-503-0021, Remodel of Homeless Services Domiciliary, Lyons, New Jersey; Award: $47,728.71
14. VA247-13-Q-0604-01, Roof Repairs, Carl Vinson VA Medical Center, Dublin, Georgia; Award: $25,000

All of the solicitations previously mentioned were small business set-aside projects, many of which were for Service-Disabled, Veteran-Owned small businesses. AGC holds that the VA should not jeopardize the financial stability of these veteran small businesses, whose development and well-being is within the VA's mission, for a short-sighted and unproven construction services procurement method already abandoned by the largest federal construction agency.

Additionally, these VA contract awards were for the procurement of professional construction services and not for the purchase of a simple commodity, commercial item or mere maintenance. AGC holds that the VA misclassified these contracts, often as some form of simple maintenance rather than as professional construction services. For example, the VA Northern California Health Care System awarded a nearly $900,000 contract (VA261-13-B-0854) for "numerous interior renovations throughout multiple buildings at the San Francisco VA Medical Center. . . [for which] [t]he contractor shall provide all labor, materials, and equipment."

Here, the VA sought to solicit construction services under the guise of simple maintenance of structures and facilities. However, under no circumstance were the tasks equivalent to cleaning bathrooms. In fact, the solicitation called for over 20 rooms to be renovated in some fashion, including but not limited to work on flooring, plumbing, mechanical and electrical installation. The solicitation also included construction services calling for the use of fire-stopping construction practices and construction operations occurring during business hours in a hospital facility. Additionally, construction services contractors were responsible for worksite safety for the contractor workforce and the VA facilities employees and patients.

For another example, the Carl Vinson VA Medical Center in Dublin, Georgia, awarded a $25,000 "roof repair" contract (VA247-13-Q-0604-01) as a simple "repair or alteration of structures and facilities." However, this project was not merely a roof repair; it appears to be a

complete roof replacement. Roof replacement is a complex construction service. It should not be procured through a game-like, online reverse auction process in which price is the only factor.

Whatever the cost of the total project, construction requires professional expertise. It is subject to, among other things, weather conditions, rapidly changing diesel fuel and material prices, as well as conditions that introduce an extreme degree of variability to construction, like changing labor supply, workforce safety, and equipment costs and time. Additionally, construction projects can include unforeseen site issues, such as the existence and necessary safe removal of hazardous materials that were not disclosed to the contractor or known to the owner.

The complexities of these processes simply do not compare to the purchase of an off-the-shelf commercial item or mere maintenance. The reverse auction process ignores the expertise of the contractor or the unique nature of construction. Construction contractors, specialty contractors, subcontractors and suppliers offer and provide a mix of services, materials and systems. Again, they do not "manufacture" buildings, highways, or other facilities.

ii. General Services Administration

In 2013, GSA launched an online reverse auction platform (http://reverseauctions.gsa.gov/) that enables any federal agency to procure construction services through a reverse auction. AGC notified GSA that it should remove from its Reverse Auction Platform the construction services options outlined in Schedule 56—noted below.

Specifically, the Reverse Auction Platform enables federal agencies to procure "Buildings and Building Materials, Industrial Services & Supplies" through Schedule 56. Schedule 56 includes "Ancillary Repair and Alteration requiring minor construction (includes Davis Bacon and construction clauses); and Installation and Site Preparation requiring Construction, which is necessary for Roof Repair or Replacement, to install a Pre-Engineered or Prefabricated Building or Structure, to install an Above Ground Storage Tank or to Install Alternative Energy and Power Distribution Solutions (includes Davis Bacon and construction clauses) " and construction of foundations.[5]

While GSA may intend for the procurement of what is misclassified as "simple," "ancillary" or "preparatory" construction services through a reverse auction, in practice, such undefined terms could allow for federal agency misuse of the Reverse Auction Platform, costing the federal government—and taxpayers—more in the long run. Determining which contractor is the most qualified at the lowest price to clear and improve land for construction, construct a building foundation, install prefabricated buildings, and repair roofs, among other things in Schedule 56, demands that a procurement agency evaluates a host of source selection factors together, which reverse auctions do not consider. For example, installation of prefabricated buildings can require a degree of design-build project delivery expertise that varies among contractors. However, a reverse auction only evaluates price, whereas established federal procurement practices allow for the consideration of this expertise.

[5] GENERAL SERVICES ADMINISTRATION, BUILDINGS AND BUILDING MATERIALS, INDUSTRIAL SERVICES AND SUPPLIES SCHEDULE 56: FREQUENTLY ASKED QUESTIONS (FAQS), *available at*: http://www.gsa.gov/graphics/fas/FAQs-Buildings-Schedule56.pdf

AGC fears that misclassification of major construction services as merely maintenance or repair jeopardizes the quality of construction an agency may receive through a reverse auction. Congress should not allow each agency to make its own mistakes when using reverse auctions, but rather learn from the experiences of the past.

d. Congress Must Prohibit the Use of Reverse Auctions for Construction Services Contracts

In 2014, Congress passed and the President signed into law a reverse auction provision as part of the Carl Levin and Howard P. 'Buck' McKeon National Defense Authorization Act for Fiscal Year 2015. The provision prohibits the Department of Defense from conducting single bid reverse auctions and reverse auctions for design-build military construction projects. While the law enacted last year is a step in the right direction, it neither addresses the vast majority of construction services reverse auctions for which small business would otherwise compete, nor does this law address all federal construction agency use of reverse auctions for construction. In fact, AGC is not aware of any agency ever conducting or having considering conducting a reverse auction for the construction of a design-build military construction project.

As our testimony and the record evidence, the experiences of one federal agency do not necessarily mean another federal agency will learn from them. Rather, we find that each federal agency learns the mistake of construction services reverse auction procurement on its own. This will neither benefit competition and the construction industry—especially small businesses—nor the American taxpayer. As such, AGC holds that the only solution is for Congress to enact a law that prohibits reverse auction procurement for construction services government-wide.

II. Reform Design-Build Contracting

Federal agencies have a number of different options in how they can procure design and construction services that will, in turn, affect who performs the different stages of a project. One of those options is design-build. Under design-build procurements, a single entity—the construction and design team—submits proposals for both the design and construction of the project.

Design-build is different from the traditional construction procurement method: Design-Bid-Build. Under design-bid-build, the design work, i.e., final construction drawings and specifications, is completed under a separate contract for design. These separate design contracts are most often competed for and awarded to architect-engineer (AE) firms. The federal agency will then ask contractors to compete for the construction contact, based on the design documents completed under the prior, separate design contract.

AGC recommends that owners—both public and private—select the project delivery systems that best fit their particular needs but with due regard for their independent interest in an open and competitive construction industry. As such, AGC is project delivery system "neutral" and merely recommends the project delivery system that fits each owner and project's particular and unique

needs. Many federal agencies have come to prefer design-build for a number of reasons, including the improvements in time of delivery and efficiency inherent in reducing the number of "steps" in the procurement process. Also, as design-build has become established in the federal contracting industry, agencies, designers and contractors have learned to use the close-working relationships inherent with this contracting method to better address the particular project needs of the federal end-user client.

a. One-Step versus Two-Step Design-Build Procurement

i. Congress Should Reasonably Limit One-Step Design-Build Procurements to Ensure Robust Competition

In general, there are two major types of design-build procurement:

1. Two-step design-build; and
2. One-step design-build.

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.

1. Two-Step Design-Build Procurement Explained

Generally, during the first step of the two-step design-build option, the issuing federal agency limits the proposal submission requirements to the qualifications of the offering design-build "teams." These qualification criteria are most often evidence of past experience with the specific facility type; client performance evaluations for that past work; and sometimes other performance criteria such as safety ratings, bonding, etc. Design-build teams are inclined to submit proposals for these relatively simple first-step opportunities, because this information is readily available in their company records and inexpensive to gather and present. As a result, the federal agency obtains a good quantity of qualified proposals to choose from and can be confident that they can select the best qualifiers for "second-step." Furthermore, the first-step review effort by the federal agency is similarly inexpensive, as they can quickly and easily judge the submitted qualification information.

In the "second step" of the two-step procurement the federal agency generally selects three to five teams to submit much more detailed technical proposals, including extensive and expensive design information. This step is sometimes referred to as the "short-list." When design-build teams know that they will be competing against a reasonable, limited number of other teams in step two, they can justify the significant technical proposal expense by weighing the risk of submitting such a proposal with the odds of winning the contract. This provides a degree of certainty and acceptable business risk that encourages more robust competition and design innovation. From this short list, the federal agency selects one design-build team for contract award.

2. One-Step Design-Build Procurement Explained

In the single-step design-build option, in contrast, there is no qualification "first round." Instead, all interested design-build teams must submit full proposals, requiring extremely large costs necessary for each team to prepare the technical and design documents (described in step two of the two-step option above). Design-build teams considering pursuit of a "single-step" proposal have no way to judge their prospects for success, as no team can be sure how many teams are pursuing the project. As a result, competition suffers because many qualified teams, especially small businesses like mine, choose not to incur these large costs to participate where perhaps 20 teams or more can offer. 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? Also, how does the government benefit from spending significant time and resources thoroughly evaluating all 20 proposals, some of which may be from unqualified teams?

AGC holds that agencies should strive to reasonably limit single-step design-build procurement to less complicated and less expensive projects, where very little design work is required for submission with the proposal.

ii. Recent Contractor Examples of Inappropriate One-Step Design-Build Projects

As my own anecdotal example of this dilemma, my company teamed with a large business firm to pursue a one-step aircraft maintenance hangar proposal (approximately $40 million in size). The technical submission requirements emphasized energy efficient design as the main selection criteria. Our team made sense, because my firm has extensive hangar experience and our joint-venture partner had extensive experience in high-efficiency energy system design and construction. Our team expended in excess of $100,000 in design and proposal costs, but our offer was not selected based in part on the government rating our qualifications lower than our competition. We later learned that more than 20 firms offered, meaning that if our expense was "typical," this proposal generated at least $2 million of industry expense, most of which went unrewarded. The agency could have dismissed my team, and perhaps many others, on this analysis of our qualifications by way of a two-step approach, saving all of us much expense and wasted time, and saving themselves a lot of source selection review effort. In my case, this unsuccessful expenditure limited my opportunity to pursue other projects, both while working on this offer and afterwards as a result of the impact on our company budget for proposal "pursuit."

In addition, AGC has received anecdotal complaints from members over the years on this issue. Most recently, AGC members were particularly concerned about two expensive and complex projects: one at the U.S. Military Academy at West Point, New York and another at Fort Carson, Colorado. At the West Point project, the U.S. Army Corps of Engineers (USACE) issued a request for proposal for a $170 million project under one-step design-build procurement. Similarly, at Fort Carson, USACE solicited a $100 million barracks project under the one-step process. In both cases, AGC alerted USACE that the prohibitive cost of entry into such high dollar, complex one-step design-build competitions in conjunction with low odds of winning awards can serve to decrease the number of qualified teams, often eliminating small business participation in total.

To the credit of the USACE Headquarters, in response to industry concerns at the Fort Carson project in particular, the agency issued an Engineering and Construction Bulletin[6] in August 2012 to serve as agency-wide guidance for when the one-step design-build process could be used. However, AGC recognizes and respects that USACE implementation of reasonable and consistent policies across an agency with such a wide scope is a challenge. USACE is tasked with ensuring the safe, secure and efficient construction of the nation's military and civil works infrastructure and facilities at home and abroad across 38 District offices within 8 Divisions. In the case of this particular guidance, AGC members have seen some inconsistency between the USACE Districts in policy implementation.

b. Final Round of the Two-Step Design-Build Procurement:

i. Congress Should Reasonably Limit the Final Round to Three to Five Construction and Design Teams

As previously noted, during the two-step design-build procurement process, a federal agency selects a limited number of finalists to enter the second-step of the competition and to submit full proposals with more complete—and more expensive—design materials and cost estimates. AGC has long held and supported the reasonable limitation of the second-step selection to three to five finalist construction and design teams. Such a range of finalists still allows for a sufficient and reasonable competition, allowing federal agencies and taxpayers to realize the benefits of robust competition without driving away qualified competition. As with the example of 20 proposals in the one-step design-build process, the less predictable the competition and the odds of success, the more likely qualified teams do not compete.

Like AGC, I strongly support full and open competition for the many contracts necessary to construct improvements to real property. I recognize that the reviewer might ask how AGC and I can still support full and open competition while arguably advocating for limiting competition during this second-step of design-build procurement. I respectfully submit that by limiting the finalists in the final round of the two-step procurement, federal agencies will help ensure that they receive pre-proposal packages from any and all interested and qualified construction and design teams, including small businesses like mine. Such predictability allows businesses to consider the odds of participating in an expensive proposal process, as opposed to the one-step procurement process. As a result, this defined competition certainty with less risky odds for success encourages greater competition in the first-step of the two-step design-build process.

c. Congress Must Reform Design-Build Contracting Government-Wide to Encourage Small Business Participation

As with reverse auctions, Congress in 2014 passed a design-build reform provision as part of the Carl Levin and Howard P. 'Buck' McKeon National Defense Authorization Act for Fiscal Year 2015. The provision effectively limits the second-step of design build procurement to no more than

[6] U.S. ARMY CORPS OF ENGINEERS, LIMITATIONS ON THE USE OF ONE-STEP SELECTION PROCEDURES FOR DESIGN-BUILD. ENGINEERING AND CONSTRUCTION BULLETIN, AUG. 6, 2012 *available at:* http://www.wbdg.org/ccb/ARMYCOE/COEECB/ARCHIVES/ecb_2012_23.pdf

5 teams on projects over $4 million. However, the head of the contracting activity, i.e., the head of the Army Corps or Naval Facilities Engineering Command, may approve a contracting officer's written justification to include more than 5 teams when it is in the government's interest.

While this provision is an excellent start, it only applies to the Department of Defense, and not to civilian construction agencies within the federal government. Congress should extend that provision to civilian construction agencies. In addition, Congress has not addressed the issue with regards to one-step design-build. Consequently, AGC strongly urges Congress to support passage of legislation that reasonably limits one-step design-build procurements to ensure robust competition, especially for small business.

III. Encourage Sensible Consideration of Past Performance Records in the Joint Venture and Teaming Context

AGC and its members find that federal agencies continue to bundle and consolidate construction contracts, including in the small business set-aside context, despite statutes and regulations meant to counter these practices. Many of these set aside projects are valued well above the $36.5 million small business general contractor threshold set by the U.S. Small Business Administration.[7] As a result, the only way a small general contractor business can bond and have the capacity to complete the work is to joint venture or team with a larger general contractor or another small business. However, federal agencies have set up procurement road blocks preventing or limiting joint ventures.

Specifically, federal agencies are not allowing small businesses and their joint venture/teaming partners to submit their individual companies' past relevant experience to prove their qualifications for the project. Rather, agencies demand that the small business and joint venture/teaming partner use past relevant experience that they have performed **together** or otherwise be disqualified from consideration. In most cases, these companies have not worked together in a joint venture/teaming context, but perhaps in a more traditional prime and subcontractor relationship. Even so, under the federal agencies requirements, many small businesses are being turned away from the competition.

a. Background on Past Performance and Relevancy

[7] For example, in 2013, the Naval Facilities Engineering Command set aside for small business a $70 million design-build project for the construction of a communication information systems operations complex at Camp Pendleton, California (Solicitation Number: N6247312R5015; https://www.fbo.gov/?s=opportunity&mode=form&id=3e089d706c24de811567b36e70599518&tab=core&_cview=0). Small businesses in the San Diego area vehemently complained that they could not objectively perform the work alone as a general contractor. The Department of Veterans Affairs is currently seeking to set-aside for small business a $98 million design build project for the construction of a new bed tower at the VA Medical Center in Tampa, Florida (Solicitation Number: VA10115N0051; https://www.fbo.gov/index?s=opportunity&mode=form&id=52271f630cd090b5729d8e5abc2be503&tab=core&_cview=0). Again, small businesses note that they cannot perform this work alone as a general contractor and must joint venture or team with a larger general contractor.

Federal agencies must record and submit contractor performance evaluations during and at the conclusion of a project. Agencies then use these evaluations when considering contractors for future projects during the procurement process. During construction procurement, federal agencies require general contractors interested in winning a contract award to submit evidence of relevant past experience. To be relevant, the past project must have been completed generally within the last 5 or 6 years and be similar in scope to the currently solicited project. The past experience portion usually relates back to the past performance evaluations on other federal projects.

b. Background on Teaming Agreements and Joint Venture Agreements

When two businesses pool their resources, they can often achieve goals that each company could not reach as individual entities. A joint venture agreement allows two companies to work together on a specific project as partners. A teaming agreement functions as a contractor/subcontractor relationship in which a larger company subcontracts out specific tasks to smaller companies.

Many small general contractor businesses are not capable of performing or bonding a significant percentage of the procurements set aside for small businesses by themselves. Similarly, many larger business concerns acting alone are ineligible to compete for small business set-asides because of their size. These realities make it desirable for small business contractors to team with other small businesses or with large businesses to enable the small business contractor to successfully compete for and perform small business set-aside contracts. The most common working arrangements are joint venture agreements and teaming agreements.

Joint ventures are generally considered to be independent legal entities separate and distinct from the entities that form them. Joint ventures have the ability to compete for and receive federal contract awards as prime contractors, to subcontract work to other contractors, and to receive work as subcontractors on federal contracts.

Teaming agreements are essentially contracts between a potential prime contractor and one or more potential subcontractors in which the prime contractor agrees to subcontract a designated portion of the contract work to its potential subcontractor should it receive the prime contract award. Teaming agreements are extremely flexible tools for prime contractors and subcontractors to form binding cooperative relationships to compete for federal contracts.

c. Hypothetical of What's Occurring Regarding this Issue

Jack Small Business Construction ("Jack") and Jill Small Business Construction ("Jill") have worked successfully for decades in the federal construction market. However, they have never joint ventured or teamed on any construction projects in the past. Both businesses' gross revenues are $10 million annually and fall within the small business dollar thresholds allowing them to compete for small business set-aside contracts.

A federal agency sets aside a $20 million construction project. Neither Jack nor Jill have the capacity to individually bond or perform that construction project. But, together, they could do so.

Jack and Jill form a joint venture for the purposes of bidding on and performing the work for federal agency's $20 million project. The federal agency requires that Jack and Jill submit examples of past experience on similar and relevant projects which they have performed together in the joint venture. Jack and Jill have never worked together in a joint venture. As a result, they offer the outstanding and relevant past performance records their companies have amassed individually.

The federal agency does not accept Jack and Jill's individual past performances records as relevant to their work as a joint venture. As a result, Jack and Jill cannot compete for the $20 million contract. These small businesses miss an opportunity to compete and perform as a joint venture because the federal agency will not even give them a chance to work as a joint venture.

d. Congress Must Legislate that Federal Agencies Sensibly Consider Past Performance Records in the Joint Venture and Teaming Contexts

The example above represents a problem that is increasingly occurring across federal construction agencies. AGC questions how small businesses, and even non-small businesses, can compete or work as joint ventures when the federal government is not willing to give them an opportunity. As such, AGC strongly supports a sensible legislative solution to ensure that federal agencies reasonably consider the individual past performance records of construction contractors seeking to joint venture or team, even if they have not ever done so.

IV. Prevent Unintended Consequences of Misinterpretation of the Nonmanufacturer Rule

Under the Nonmanufacturer Rule (NMR), small businesses contracting with the federal government for goods must ultimately receive such goods from a small business. The purpose of the NMR is to prevent pass-through situations under which small businesses act as a front for larger businesses in the federal procurement of goods through small business-set aside contracts. The NMR has not traditionally applied to federal contracts for services in the small business context.

Recently, the Court of Federal Claims (COFC) in *Rotech Healthcare, Inc., v. U.S.*, struck down Small Business Administration regulations that limit the NMR only to procurements that have been assigned a manufacturing North American Industry Classification System (NAICS) code, or to the supply component of a manufacturing or supply contract that also has a services component. Thus, the court found that the NMR applies to all contracts for goods. Consequently, services contracts through which the procurement of goods may be necessary could fall under the NMR. The result of such an interpretation when applied to the construction contracting industry would be far reaching and extreme. Under such an interpretation, small business construction contractors would have to purchase materials and supplies through small businesses.

Let's take an example of a small business contractor building a hospital wing for the U.S. Department of Veterans Affairs through a small business set-aside contract. Building a portion of a hospital is not a simple task. Contractors will often have to build facilities that require the installation of medical equipment, bedroom materials, and kitchen or cafeteria equipment. To treat our nation's veterans, the VA may require medical equipment that is not produced by a small business or not at the same standards. Should the contractor find replacement medical equipment that may be suitable, but all be less so, to satisfy the court's new interpretation of the NMR? Should our nation's veterans and their doctors have a smaller, and perhaps lower standard choice in the medical equipment—x-ray machines, scanners? Additionally, what if there is no steel, concrete or other small business building material suppliers located within 100 miles of the VA hospital location? Should the VA have to pay a premium to receive these materials from a remote small business to ship them to the site? Would not the money be better spent on caring for the medical needs of the nation's veterans?

The court's ruling would also place small business general contractors in another precarious position as a result of the False Claims Act. Under the court's interpretation of the NMR, when a small business general contractor purchases materials or supplies they would have to be from a small business at the time of purchase. The difficulty many AGC members encounter is either: (1) businesses intentionally misrepresent their small business status; or (2) businesses are unaware that they have graduated from the small business program but continue to represent themselves as small businesses. A general contractor does not have the ability to affirmatively determine whether or not the financial statements of its suppliers merit their certification as a small business at the time of purchase. All a general contractor can do is rely on the word of that small business supplier that it is such. However, in the event that small business supplier is not in fact a small business, the general contractor would be held liable by the federal government under the False Claims Act, as well as the court's interpretation of the NMR.

In short, AGC believes the Court of Federal Claims decision would place the entire small business construction industry and the federal owners it services in an incredibly difficult position to the detriment of all parties. AGC strongly supports this Committee's endeavor to draft reasonable legislation to address this new NMR rule interpretation, before it is too late.

V. Help Prevent Fraud in the Federal Surety Bond Market

a. Background on the Suretyship and the Miller Act in Federal Construction

Suretyship is a very specialized line of insurance that is created whenever one party guarantees performance of an obligation by another party. There are three parties to a surety agreement:

1. The principal (i.e., general contractor) is the party that undertakes the obligation.
2. The surety (i.e., an insurance company) guarantees the obligation will be performed.
3. The obligee (i.e., the federal agency) is the party who receives the benefit of the bond.

A surety bond is a written agreement that usually provides for monetary compensation in case the principal fails to perform the acts as promised. The Miller Act of 1935 (41 U.S.C. Section 3131

et. seq.) generally requires general contractors on federal public works projects to post two surety bonds as a condition of awarding the contract:

1. A performance bond guaranteeing performance of the work; and
2. A payment bond guaranteeing payment of subcontractors and suppliers.

While the burden is on the prime contractor on a federal project to provide Miller Act bonds, the bonds do not protect the general contractor. Rather, the bonds are for the benefit and protection of the United States government owner—i.e., a federal agency—and subcontractors and suppliers. For instance, if the general contractor defaults in the performance of its work or is terminated, the federal government may turn to the surety to step in and take over the general contractor's obligations under the prime contract. The Miller Act also benefits subcontractors and suppliers. Subcontractors and suppliers cannot assert a lien against federal property. The Miller Act protects eligible subcontractors and suppliers against nonpayment by providing them with an alternative means of recovery should the general contractor fail to make payment on federal projects. Under the Miller Act, qualifying subcontractors and suppliers may bring a civil action on the payment bond for any unpaid amounts.

Under current federal law and regulations, construction contractors for the federal government have three options for securing their surety obligations:

1. 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.
2. General 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.
3. Individuals, real flesh and blood people, can pledge their personal assets to back the contractor's obligations. Such individuals are called "individual sureties." Only individual sureties are permitted to pledge assets that are 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 that individual sureties need to give federal contracting officers is a document listing the assets and their value, representing that they are pledged in an escrow account to secure the contractor's obligations.

b. Individual Sureties can be the Bernie Madoffs of the Federal Construction Industry

Individual sureties are approved directly by federal agencies contracting officers on a project-by-project basis. Federal contracting officers are not immune from deception since they do not have the resources necessary to carefully vet individual sureties. Contracting officers are used to relying upon the Treasury Department to perform the legwork necessary to assess surety insurance qualifications. Neither the Treasury Department nor state insurance commissioners rate individual sureties. Federal contracting officers are simply on their own to verify the value and integrity of pledged assets that are hard to determine ownership and value as well as liquidate in the event of default. The reality, though, is that contracting officers are not equipped to act as appraisers, underwriters and risk mangers. The window for fraud is gaping; and there are hosts of examples of such fraud.

In *United States ex rel. JBlanco Enterprises Inc. v. ABBA Bonding, Inc.*,[8] an individual surety submitted bonds on a federal project in Colorado supported by an affidavit that the surety had a net worth of $126 million. No assets were placed in escrow, but the U.S. General Services Administration accepted the bonds. Shortly thereafter, the individual surety filed for bankruptcy and it was clear that most of the $126 million never existed.

In 2014, an AGC member acting as a subcontractor on a U.S. Army Corps of Engineers project at Ft. Hood fell victim to an individual surety's false assets. The individual surety at issue was IBCS Fidelity owned by Edmond C. Scarborough. Mr. Scarborough and his company are widely known throughout the construction industry. He—and other notorious individual sureties like him—run their businesses like Ponzi schemes. They back federally required surety bonds with hard-to-value and often difficult to liquidate assets, like real estate—homes or land—and personal property—like stamp collections. They collect revenue from bond fees and, more often than not, do not have to pay out on the bonds as the general risk of contractor default is low. However, when a default does occur and indemnification is sought on the bonds, these individuals often go bankrupt, leaving the federal government—on performance bonds—and subcontractors—on payment bonds—without means of payment.

In the case of Mr. Scarborough, the *Engineering News Record* (ENR) magazine published a series of stories on him. He backed his bonds with about 15 million tons of Kentucky and West Virginia usable coal waste.[9] He valued that coal waste at $190 million. However, his recent bankruptcy filings report those assets to be worth $120,000.[10] When the economy turned for the worse and Bernie Madoff's clients sought to cash in their assets, the reality that there was no value in those assets became apparent. Similarly, when contractors defaulted and the government and subcontractors needed payment from Mr. Scarborough, the assets pledged did not meet the obligations for which they were required. And, as with Bernie Madoff, the people that relied on Mr. Scarborough and their small businesses were left holding an empty bag. The AGC member subcontractor who relied on Mr. Scarborough's bonds for payment may get pennies on the dollar for the work it completed on the USACE project.

c. Congress Must Adopt Legislation Preventing Fraud in the Individual Surety Market

The problem of individual sureties using illusory assets to back their bonds to the "benefit" of U.S. Government and to subcontractors and suppliers is real. The solution is simple. Congress must require that individual sureties use real, liquid assets backed by the full faith and credit of the U.S. Treasury when posting their bonds. To fail to do otherwise will allow the Bernie Madoffs and Edmond Scarboroughs to continue to open shops in the federal construction market.

---

[8] *See* No. 07-cv-01554-REB-CBS, 2009 WL 765875, at *1–2 (D. Colo. Mar. 20, 2009).

[9] Richard Korman, *A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid*, ENGINEERING NEWS-RECORD, Feb. 27, 2013, *available at*: http://enr.construction.com/business_management/ethics_corruption/2013/0225-a-bold-individual-surety-claims-his-coal-backed-bonds-are-rock-solid.asp

[10] Richard Korman, *Controversial Individual Surety Files for Bankruptcy Protection*, ENGINEERING NEWS-RECORD, Aug. 5, 2014, *available at*: http://enr.construction.com/business_management/finance/2014/0805-outspoken-individual-surety-files-for-bankruptcy-protection.asp

In conclusion, I again thank the Committee for inviting AGC and me to testify before you on these critical industrial base issues the construction industry faces. The association and I look forward to working with you on achieving legislative progress on these issues.