

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

To: Members, Subcommittee on Contracting and the Workforce, Committee on Small Business

From: Committee Staff

Date: February 7, 2012

Re: Hearing: "Construction Contracting: Barriers for Small Business Contractors"

On Thursday, February 9, 2012, at 10:00 am, in Room 2360 of the Rayburn House Office Building, the Subcommittee on Contracting and Workforce of the House Committee on Small Business will meet for the purpose of receiving testimony on construction contracting and barriers related to small businesses. The hearing will specifically address the following areas that often limit small businesses from effectively competing on construction projects: 1) contract bundling; 2) the sealed bid and negotiation contract award process; 3) subcontracting credit allowance; 4) subcontractor payments; 5) retention; 6) surety bond issues; and 7) the desirability of a locality preference.

Witnesses on the first panel will include Mark McCallum, Chief Executive Officer, National Association of Surety Bond Producers; Dirk D. Haire, Partner, Fox Rothschild on behalf of the Associated General Contractors of America; and Ms. Rosie Privitera Biondo, Mark One Electric Co., Inc., on behalf of the Women Construction Owners and Executives. The second panel will consist of witnesses from the federal government, including William Guerin, Assistant Commissioner of the Office of Construction Programs, Public Building Service Commissioner, General Services Administration (GSA); James C. Dalton, P.E., Chief of the Engineering and Construction Division, Directorate of Civil Works, Headquarters, United States Army Corps of Engineers (USACE); and Jeanne Hult, the acting Associate Administrator for Capital Access, Small Business Administration (SBA).

I. Introduction

Federal construction means the initial construction, alteration, or repair (including dredging, excavating, and painting) of buildings, structures, or other real property.¹ Of the over \$500 billion the federal government spends annually through contracts for goods and services,² approximately 6.5 percent is spent on federal construction.³ As displayed in Table 1, the majority of those dollars were expended by the

¹ See 48 C.F.R. § 2.101, § 22.502 and § 22.502 (2010). For purposes of this definition, the terms buildings, structures, or other real property include, but are not limited to, improvements of all types, such as bridges, dams, plants, highways, parkways, streets, subways, tunnels, sewers, mains, power lines, cemeteries, pumping stations, railways, airport facilities, terminals, docks, piers, wharves, ways, lighthouses, buoys, jetties, breakwaters, levees, canals, and channels.

² Prime Award Spending Data, List View, USASpending.gov, available at <http://www.usaspending.gov> (last accessed Feb. 2, 2012). The total spent was \$535.9 billion in FY 2011, and \$538 billion in FY2010.

³ Federal Procurement Data System ad hoc report, available at <https://www.fpds.gov> (last accessed Feb. 2, 2012) Copy on file with the Committee.

Department of Defense (DoD),⁴ with nearly 60 percent of DoD's spend coming through USACE.⁵ Among civilian agencies, GSA, as the manager of all public buildings, was responsible for a major share of the work.⁶ In each case, small businesses were well represented, with over 40 percent of total construction spend, and over 23 percent of Architect & Engineering (A&E) work. The federal sector is a significant and growing portion of the construction market, accounting for 40 percent of the value of ongoing overall private and public sector construction activity in 2010, compared to about 20 percent in the prior decade, with a special focus on industrial/heavy construction.⁷

Table 1. FY 2010 Federal Contracts for Construction and A&E⁸

	Construction (Percent to Small Business)	A&E (Percent to Small Business)
Federal Government	\$28,762,077,118.47 (42.88%)	\$5,323,431,980.15 (23.38%)
DoD	\$19,013,262,754.31 (41.59%)	\$2,950,136,004.49 (23.97%)
GSA	\$3,154,991,393.56 (25.74%)	\$430,968,934.90 (25.84%)

According to an analysis of new federal employment data released by Associated General Contractors, the construction industry added 21,000 jobs in January 2012⁹ due in part to the federal stimulus funding.¹⁰ However, the contracting process is laden with regulatory requirements that are costly, burdensome, and often preclude small businesses from effectively competing on contracts, especially construction contracts. These statutory and regulatory barriers prescribe, for example: bundling of requirements; the method an agency uses to solicit and award a contract; the prime contractor subcontracting credit allocation; the payment terms for construction contractors; the effectiveness of SBA's surety bond program; and the use of local workers. This memorandum enumerates some of the primary challenges facing small business construction companies seeking federal contracts.

II. Barriers in the Contracting Process

1. Contract Bundling

The Small Business Act (the Act) defines the bundling of contract requirements as:

consolidating 2 or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract

⁴ *Id.*

⁵ Government Accountability Office, *Prior Experience and Past Performance as Evaluation Criteria in the Award of Federal Construction Contracts*, GAO-12-102R, (October 18, 2011) available at <http://www.gao.gov/products/GAO-12-102R>.

⁶ Prime Award Spending Data, List View, USASpending.gov, available at <http://www.usaspending.gov>.

⁷ U.S. Census Bureau, *Value of Construction Put in Place, Annual Data*, available at <http://www.census.gov/const/C30/ototal.pdf>.

⁸ Federal Procurement Data System ad hoc report, available at <https://www.fpds.gov> (last accessed Feb. 2, 2012) Copy on file with the Committee.

⁹ *Construction Employment Hits Two-Year High In January But Industry's 17.7 Percent Unemployment Rate Remains Double Overall Rate*, available at http://www.agc.org/cs/news_media/press_room/press_release?pressrelease.id=1020.

¹⁰ Federal stimulus funds for construction was authorized in the American Recovery and Reinvestment Act (Recovery Act) of 2009, available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1enr.pdf. DOD Information Related to the American Recovery and Reinvestment Act of 2009 report, available at <http://www.defense.gov/recovery/>. U.S. General Services Administration American Recovery and Reinvestment Act Agency-wide Recovery Plan, available at http://www.gsa.gov/graphics/admin/GSA_ARRA_Agencywide_Plan_v.2.pdf.

that is likely to be unsuitable for award to a small-business concern due to—

- (A) the diversity, size, or specialized nature of the elements of the performance specified;
- (B) the aggregate dollar value of the anticipated award;
- (C) the geographical dispersion of the contract performance sites; or
- (D) any combination of the factors described in subparagraphs (A), (B), and (C).

15 U.S. C. § 632(o)(2).

However, since the Act proceeds to define “separate smaller contract” as “a contract that has been performed by one or more small business concerns or was suitable for award to one or more small business concerns,” some agencies have interpreted it as not applying to new construction, since new construction, by definition, has not previously been performed by small businesses.¹¹

The Act requires each federal department and agency to: (1) structure contracting requirements to facilitate competition by and among small business concerns, taking all reasonable steps to eliminate obstacles to their participation; and (2) avoid unnecessary and unjustified bundling of contract requirements that may preclude small business participation in procurements as prime contractors. However, agencies do apply these requirements consistently to new construction work. Likewise, the Federal Acquisition Regulation (FAR) provisions intended to protect small businesses from unjustified bundling may not be included when the contracting officer (CO) is evaluating the requirement.¹² In some cases, the statute recognizes that contract bundling may be more efficient, save money or be necessary in order to support specific technical, quality, or design requirements and must be permitted.¹³ Even, the Administration acknowledges that bundled procurements limit competition and do not allow small businesses to compete for government business, so their effect must be mitigated.¹⁴ Balancing the benefits of bundling against its disadvantages may be complex, but needs to be addressed to ensure small businesses have a fair opportunity to compete for construction work.

2. Sealed Bidding and Negotiated Contract Awards

Generally, the term “sealed bidding” is used to describe a process where bids are all submitted by a time certain, publicly opened and recorded, with immediate award to the lowest bidder; however, within the construction industry it is commonly preceded by a round when an offeror’s technical capability is evaluated.¹⁵ The FAR allows the use of sealed bidding only when time permits, price will be the determinative factor for award, there is no need to conduct discussions or negotiations with the offeror, more than one bid will be received, and the work will be performed inside the United States.¹⁶ Traditionally, the sealed bid selection procedure was a practical option for the selection of contractors for construction projects, but in FY 2006 only 11 percent of construction contract dollars, and 22.7 percent of contract

¹¹ 15 U.S.C. § 632(o)(3).

¹² These include: (1) conducting market research to determine whether bundling is needed and justified; (2) justifying the determinations in acquisition strategy documentation that identifies measurably substantial benefits that meet the statutory and regulatory requirements; and (3) conferring with SBA representatives on their acquisition strategies. *See, e.g.*, 48 C.F.R. §§ 7.103-105, § 8.404, § 15.304(c), § 16.505(a), and § 19.4.

¹³ 15 U.S.C. § 644(a).

¹⁴ National Economic Council, THE SMALL BUSINESS AGENDA: GROWING AMERICA'S SMALL BUSINESSES TO WIN THE FUTURE, 19 (2011) available at <http://www.sba.gov/sites/default/files/Small%20Business%20Agenda%20NEC.pdf>.

¹⁵ 48 C.F.R. § 14.

¹⁶ 48 C.F.R. § 6.401. *c.f.*, A&E work may only be award by negotiated contracts. *Id.* at §36.6.

actions, were awarded using the sealed process.¹⁷ While the use of sealed bid construction awards has declined, small businesses still complain of two defects in the sealed bidding process: bid shopping and bid peddling.

Bid shopping is the practice of using the bid amount of one competitor by a contractor “to secure a lower proposal from another bidder that [for] project.” Bid peddling is the practice of subcontractors and suppliers requesting “information from the contractor regarding any sub bid in order to submit a lower proposal on that project.”¹⁸ All of the major construction trade associations have renounced these practices as “business practices that threaten the integrity of the competitive bidding system.”¹⁹ When bid shopping and peddling occur post award on a sealed bid, the government does not see any resultant cost savings, and subcontractors allege that these practices lead to “substitutions of materials and poor performance, contract disputes and defensive contract administration, and claims and litigation.”²⁰ Consequently, ten states, including California, South Carolina, and North Carolina have forbidden the practice by requiring that prime contractors list their subcontractors as part of the bid process.²¹

GSA’s Public Buildings Service had a bid listing policy from 1963 until 1983, when it abandoned the policy because “bidding problems and protests related to the listing of subcontractors requirements have adversely affected the GSA construction program.”²² The Federal Register Statement continued to state, “[t]hese problems have resulted in delays in award of contracts and in some cases the rejection of low bids, thereby preventing the timely completion of important projects and resulting in higher procurement cost.”²³

3. Credit for Subcontracting Goals

In order to ensure the maximum practicable utilization of small businesses, the federal government has a goal of awarding 23 percent of all prime contract dollars to small businesses, five percent of prime and subcontract dollars to women-owned small businesses (WOSB) and to small disadvantaged businesses (SDBs), and three percent of prime and subcontract dollars to service-disabled veteran-owned small businesses (SDVOSBs) and to HUBZone small businesses.²⁴ Additionally, SBA establishes a governmentwide subcontracting goal, currently set at 35.9 percent of prime contract dollars.²⁵

To achieve the subcontracting goals, large prime contractors receiving federal contract awards valued over \$650,000 (\$1.5 million for construction) are required to establish subcontracting plans and goals for each of the aforementioned five categories, both by dollar and percentage of total subcontracting opportunity.²⁶ Prime contractors are required to flow down these requirements to lower tiered large subcontractors, and all

¹⁷ *The State of Federal Contracting: Opportunities and Challenges for Strengthening Government Procurement and Acquisition Policies, Before the Subcomm. on Management, Organization and Procurement of the H. Comm. on Oversight and Government Reform*, 111th Cong. 53 (2009) (written statement of Quality Construction Alliance, citing Federal Procurement Data System) [hereinafter, QCA].

¹⁸ Associated General Contractors, American Subcontractors Association, And Associated Specialty Contractors, GUIDELINES FOR A SUCCESSFUL CONSTRUCTION PROJECT 17 (2003).

¹⁹ *Id.* The American Society of Professional Estimators forbids bid shopping or peddling in its code of ethics as unethical and unfair (copy on file with the Committee).

²⁰ QCA at 7.

²¹ *See, e.g.*, CAL. PUB. CONTRACT CODE §4100 et seq., N.C. GEN. STAT. § 143-128, S.C. CODE ANN. § 11-35-3020.

²² 48 Fed. Reg. 49,305 (1983).

²³ *Id.*

²⁴ 15 U.S.C. § 644(g).

²⁵ *See* www.sba.gov/goaling.

²⁶ 15 U.S.C. § 637(d). *See also*, 48 C.F.R. § 19.7.

large contractors must submit progress reports into the SBA's Electronic Subcontracting Reporting System (ESRS).²⁷

Subcontracting plans must contain a description of the methods and efforts used to assure that small business enterprises have an equitable opportunity to compete for subcontracts, and be submitted by contractors for review prior to the award of any contract. An acceptable subcontracting plan must include six major elements: (1) separate percentage goals for each small business category; (2) the name of the organization's subcontracting plan administrator and a description of his or her duties; (3) a description of the efforts that the company will make to ensure that all small businesses will have an equitable opportunity to compete for subcontracts; (4) assurances that the company will "flow down" the subcontracting requirements to its subcontractors; (5) assurances that the company will cooperate in any studies or surveys and submit periodic reports to the Government, including the SF 294 and 295; and (6) a recitation of the types of records the company will maintain to demonstrate its compliance with the plan.²⁸ Failure of the prime contractor to comply in good faith with its approved subcontracting plan may subject the contractor to liquidated damages or termination for default.

Subcontracting plans fall into one of four categories:

1. Individual Plan - contains the subcontracting plan elements and covers the entire contract period (including option periods), applies to a specific contract, and has goals that are based on the offeror's planned subcontracting in support of the specific contract.
2. Master Plan - contains all the required elements of an individual contract plan, *except* goals, and may be incorporated into individual contract plans, provided the master plan has been approved.
3. Commercial Plan - contains all the required elements *including* goals, covers the offeror's fiscal year and applies to the entire production of commercial items sold by either the entire company or a portion thereof (e.g., division, plant, or product line) and is effective for three years.
4. Comprehensive Subcontracting Plan – This subcontracting plan has been approved under the DoD Comprehensive Subcontracting Plan Test Program, which authorizes the negotiation, administration, and reporting of subcontracting plans on a plant, division or company-wide basis as appropriate. The purpose of the test is to determine whether comprehensive subcontracting plans will result in increased subcontracting opportunities for small business while reducing the administrative burdens on contractors.

While the government receives credit for all tiers of subcontracting, prime contractors are only given credit for first tier subcontractors. In some cases, this restriction is necessary to avoid duplication. For example, assume large business A has a commercial subcontracting plan and large business B has a test subcontracting plan. Assume A subcontracts to B on one contract, and B subcontracts to A on another contract. There would be no way to avoid double counting in these cases. However, on individual plans, which are the standard in construction contracting, there would not be a duplication issue, and providing credit for lower tier work could incentivize better prime contractor enforcement of the flow down requirements, which could in turn result in greater opportunities for small firms.

4. Subcontractor Payments

Small businesses require payment quickly, especially on construction contracts, to have access to capital to maintain their operation, pay workers and suppliers, and purchase materials. Prompt payment and payment

²⁷ 48 C.F.R. § 19.7

²⁸ *Id.*

protection for subcontractors is addressed by the Miller Act,²⁹ the Prompt Payment Act (PPA),³⁰ and the Small Business Act.³¹

The Miller Act governs the requirement for surety bonds on federal government contracts for construction, alteration, or repair of any public building or public work.³² Surety bonds are guarantees that a contractor will execute a contract at the amount bid (bid bond), perform the work to completion (performance bond) and pay its suppliers and subcontractors (payment bond). The Miller Act requires that prime contractors for the construction, alteration, or repair of federal buildings furnish a payment bond for contracts in excess of \$150,000.³³ While the bond may cover performance, for purposes of this section its crucial feature is that it guarantees payment of those supplying labor and materials in the construction of public buildings. These bonds serve as a substitute for the liens usually afforded subcontractors in the commercial sector, but which are absent from government contracts.

While the Miller Act assures subcontractors that there will be funds to pay them, the PPA deals with the timeliness of the payment.³⁴ The PPA places a clause in construction contracts requiring that prime contractors pay construction-related subcontractors for satisfactory performance within seven days of receiving payment from the government.³⁵ Furthermore, as the government is already required to pay construction prime contractors within 14 days of the receipt of proper payment request, and A&E contractors within 30 days of such a request, this should ensure timely flow of payments to subcontractors.³⁶ The Administration's recent move to 15-day payment of all small business prime contractors is intended to ease the flow of funds to subcontractors.³⁷

Furthermore, the Act was amended in 2010 to further promote prompt payment of small business subcontractors by requiring prime contractors to provide contracting officers with written notice if they fail to pay a small business subcontractor in full within 90 days of receiving payment from the contracting agency. It also directs the contracting officer to include this failure when conducting its assessment of the prime contractor.³⁸

As reported by construction subcontractors, the major flaw with the PPA and Miller Act prompt payment protections is that the small subcontractor has no way of knowing when the prime contractor has been paid. Likewise, he is not aware of whether the prime contractor has made a false representation regarding the payment of the subcontractor, or if the surety payment bond will pay out in a timely fashion to cover the subcontractor during the period of nonpayment. Given that the profit margin in the construction industry may be below one percent,³⁹ not even credit can keep a prime's failure to pay a subcontractor from potentially driving a small firm out of business.

²⁹ 40 U.S.C. § 3131.

³⁰ 31 U.S.C. § 3901 *et seq.*

³¹ 15 U.S.C. § 637(d).

³² 40 U.S.C. § 3131

³³ *Id.*, however the initial statute read \$100,000. This amount has been adjusted pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990, 28 U.S.C. § 2461 note.

³⁴ 31 U.S.C. § 3901 *et seq.*

³⁵ *Id.* at § 3905(b).

³⁶ 48 C.F.R. § 32.904(d)(1)(i), 32.904(c)(1)(ii). This raises an interesting issue as to the disparity of the payment conditions, since under design-build contracts A&E vendors may have the same need for accelerated payments as pure construction contractors.

³⁷ Memorandum from Jacob Lew, Director, Office of Management and Budget, "Accelerating Payments to Small Businesses for Goods and Services" (2011) available at <http://www.whitehouse.gov/sites/default/files/omb/memoranda/2011/m11-32.pdf>.

³⁸ 15 U.S.C. § 637(d)(12).

³⁹ "Most and Least Profitable Business Types," Bloomberg Business Week (Jan. 1, 2011) available at <http://images.businessweek.com/slideshows/20110118/most-and-least-profitable-business-types/slides/2>. Profit margin for nonresidential construction reported as 0.78%.

5. Retention

The practice of holding back a certain percentage of payment from a contractor on a construction project until performance is completed is known as retention. According to the FAR,⁴⁰ a Contracting Officer (CO) has the discretion to withhold amounts due of up to 10% if the CO determines that such a withholding is necessary to protect the government's interest and ensure satisfactory completion of the contract, and then the retainage is released when the CO determines that the work is substantially complete and that the amount retained is in excess of the amount adequate for the protection of the government. While federal government contracts do not require the primes to withhold a set percentage of retainage from subcontractors, as a matter of economic necessity the primes usually flow down the same retention percentage to the subcontractors. While primes must now report subcontractor retention, that does not mitigate the hardship the practice poses for small businesses at any tier, especially given the tight profit margins.⁴¹

6. Surety Bond Program

Bonds provide contractors with creditworthiness generally supported by the sureties that guarantee them. There are two types of sureties that can provide this guarantee: corporate and individual. Corporate sureties are incorporated entities (often subsidiaries of insurance companies) that are certified to write surety bonds in one or more states in the United States. In order to write a surety bond in the United States, a company must be licensed by the insurance department/commission of the state(s) where it desires to do business. Corporate sureties must follow strict guidelines established by the state regulatory agencies. According to the Surety Association of America, corporate sureties generate \$4.4 billion or more in written premiums annually from surety bonds. Because of their greater access to capital, corporate sureties dominate the industry, and have issued the majority of bid bonds, performance bonds, payment bonds, etc. Corporate sureties provide most of the bonding for federal construction projects and the Department of the Treasury maintains a formal list of federally approved corporate sureties.⁴²

The original source of surety bonding was the individual surety. As with corporate sureties, individual sureties require contractor applicants to pass a thorough prequalification process, but they provide greater flexibility to approve contractors for bonding. Individual sureties are not: 1) incorporated and usually are a single individual or a group of individuals who own or control a large amount of cash or other liquid assets; 2) licensed or regulated by state agencies; and 3) listed on the Department of the Treasury's list of approved corporate sureties. The assets serve as collateral to the project owners guaranteeing the project's completion. Even though individual sureties are in the minority, they still play a significant role for small businesses. Individual sureties provide a service to contractors who do not meet the criteria for and are often declined bonding by a corporate surety. Consequently, small businesses are often not provided the bond capacity needed to establish a presence in the construction industry. The FAR does permit agency COs to accept individual sureties; however, the decision as to whether or not the bid bond is acceptable is left to the CO's discretion; and not all government COs are familiar with individual sureties and their acceptable assets.⁴³ If the CO does not adequately scrutinize the individual surety, and the individual surety pledges nonexistent or insufficient assets, or the assets are not readily convertible into cash to pay the obligations of the defaulted contractor, the federal government's construction project is at risk for failure

⁴⁰ 48 C.F.R. § 52.232-5, § 52.232-10.

⁴¹ 15 U.S.C. § 637(d)(12).

⁴² Department of Treasury's Financial Management Service (FMS) administers the surety bond program for the federal government under [31 U.S.C. 9304-9308](#). FMS's Listing of Approved Sureties (Department Circular 570), available at http://www.fms.treas.gov/c570/c570_a-z.html.

⁴³ Under FAR § 28.203(c), if the contracting officer "determines that no individual surety in support of a bid guarantee is acceptable, the offeror utilizing the individual surety shall be rejected as nonresponsible."

and financial loss. As a result, many small businesses that use individual sureties are often rejected by the CO, and lose out on federal government contracting opportunities.

Since small businesses often have greater challenges proving their credit worthiness, the Small Business Investment Act (SBIA) created a surety bond guarantee program within SBA.⁴⁴ Pursuant to the SBIA, SBA can use one of two programs to guarantee bonds for contracts up to \$2 million dollars: the Prior Approval Program (PAP)⁴⁵ or the Preferred Surety Bond Program (PSBP).⁴⁶ For major disasters, SBA has the authority, for a set period of time (usually within 12 months after a major disaster declaration), to guarantee up to \$5 million for non-federal and federal contracts or orders under certain circumstances. Additionally, SBA is authorized to guarantee up to \$10 million on a federal contract under specific circumstances and if an agency head, involved in the disaster reconstruction efforts, requests it.⁴⁷

Pursuant to the PAP, SBA provides sureties with an 80 percent guarantee, meaning that if the small business fails to fulfill its obligations and the bond is called upon to pay subcontractors or the agency, SBA will reimburse the surety 80 percent of its cost. In cases where the contract is for less than \$100,000, or if the businesses seeking the surety bond is a SDB, HUBZone, veteran-owned small business (VOSB) or SDVOSB, SBA will guarantee 90 percent of the payment. To obtain the guarantee, sureties must seek prior approval from SBA before issuing the bonds, and such approval is typically granted in three days. In contrast, the PSBP only pays a 70 percent bond guarantee, but sureties are preauthorized to issue bonds and audited every three years, and are not required to seek approval before issuing individual bonds.

To fund the program, SBA charges the small business receiving the bond 0.729 percent of the contract price for the bond guarantee, and the surety company 26 percent of the fee the surety charges the small business. As of September 2011, there are approximately 5,558 active bonds with an actual bond liability of \$2.2 billion.⁴⁸ The bond program is operating at a zero subsidy from taxpayers.⁴⁹

However, over the years, the program has become less effective for small businesses. As the size of contracts has grown, the cap on the guarantee has failed to keep pace. The cap was temporarily increased to \$5 million under the American Reinvestment and Recovery Act (ARRA), but reset at the end of FY 2010.⁵⁰ While commercial sureties waive notice of all small changes to the underlying contract, SBA has stringent notice requirements and will deny a bond based on failure to notify SBA of changes, rather than based upon the prejudice to the SBA suffered. Furthermore, the guarantee rates are no longer competitive enough to encourage commercial sureties to participate, so the availability of sureties is declining.

7. Locality Preference

Federal spending on procurement contracts has remained high at a time when many other businesses have scaled back their purchases of goods and services.⁵¹ However, this spending has historically been localized in three to five states which receive nearly half of all federal procurement dollars, prompting concerns about

⁴⁴ 15 U.S.C. § 692 *et seq.*

⁴⁵ 15 U.S.C. § 694b(a).

⁴⁶ 15 U.S.C. § 694b(a)(3).

⁴⁷ U.S. Small Business Administration, "Surety Bond Guarantee Program; Disaster and Miscellaneous Amendments," 76 *Federal Register* 2571, January 14, 2011; and P.L. 110-246, the Food, Conservation, and Energy Act of 2008, SEC. 12079. Small Business Bonding Threshold.

⁴⁸ Surety Bond Program data from SBA, September 30, 2011.

⁴⁹ *Id.*

⁵⁰ 123 STAT 115, 158 (2009).

⁵¹ See, e.g., Michael Keating, *Government Contracting Remains Recession Proof*, GovPro, Feb. 2, 2010, available at <http://govpro.com/federal/government-contractors-revenue-20100202>.

whether other states receive their “fair share.”⁵² While it is logical that some work must be performed in a certain area, thus benefitting regions in or near Washington, DC and adjacent states,⁵³ it does not explain why construction contracts performed in one location fail to favor local businesses. Construction, by its very nature, is tied to a specific place. Its workforce cannot telecommute, but must be physically present at the job site each day. However, as the Subcommittee heard during its field hearing in Sumter, South Carolina, construction contracts are still going to large, out-of-state companies rather than local small businesses. This is perplexing, as out-of-state contractors must relocate their workforce or must hire the local workforce.

The federal government requires awards of contracts to the lowest qualified responsible offeror, regardless of the offeror's location. However, some provisions of federal law require or allow contracting agencies to favor vendors in certain localities. The main government-wide preferences are for “local contractors” in areas affected by presidentially declared disasters or emergencies;⁵⁴ businesses in “labor surplus areas,” or areas with particularly high unemployment;⁵⁵ and small businesses in HUBZones,⁵⁶ or census tracts, nonmetropolitan counties, or other areas with low household income or high unemployment. These preferences are explained in Table 2, on the following page:

Table 2. Comparison of Procurement Preferences for “Local Contractors,” Labor Surplus Area Concerns, and HUBZone Small Businesses⁵⁷

Category	Eligibility & Applicability	Preference Type
“Local Contractors”	Vendors must “reside or do business primarily” in a presidentially declared disaster or emergency area	Set-Asides
	Preference only for contracts for debris clearance, distribution of supplies, reconstruction, and other major disaster assistance activities	Evaluation preferences
	Set-asides can be limited to small businesses	
Labor Surplus Area Concerns	Vendors must be located in a “civil jurisdiction” with an unemployment rate 120% of the national average or 10% or higher	Tie-breaker in sealed bid procurements
	Vendors must “small” under the SBA's size standards to be eligible for tie-breaker	Evaluation factor in certain negotiated procurements ⁵⁸
HUBZone Small Businesses	Vendors must be located in a qualified census tract, qualified nonmetropolitan county, lands within the external boundaries of Indian reservations, “redesignated areas,” or base closure areas	Set-asides
		Sole-source awards
	Preferences not applicable if requirements would have been procured through Federal Prison Industries or from nonprofit	10% price evaluation preference

⁵² In FY2010, the top five states (Virginia, California, Texas, Maryland, and Florida) received 37% of federal contract dollars, while the bottom five states (Utah, Minnesota, Idaho, Oklahoma, and Louisiana) received 0.55% of federal contract dollars. *See* Federal Contract and Assistance Awards by State: Contracts, USASpending.gov, available at <http://www.usaspending.gov> (last accessed Dec. 29, 2010).

⁵³ The District of Columbia and adjacent states (i.e., Maryland and Virginia) all ranked within the top five for federal procurement spending by state in FY2010. Service contracts, which comprise over 50% of all federal contracts, are particularly likely to require vendors located near the agencies they serve.

⁵⁴ (42 U.S.C. § 5150).

⁵⁵ Executive Order 12073, Federal Procurement in Labor Surplus Areas, 43 Fed. Reg. 36,873 (Aug. 16, 1978) and Executive Order 10582, Prescribing Uniform Procedures for Certain Determinations Under the Buy-American Act, 19 Fed. Reg. 8,723 (Dec. 21, 1954) as set forth at 20 CFR part 654, Subparts A and B.

⁵⁶ 15 U.S.C. § 637(a).

⁵⁷ Location-Based Preferences in Federal and Federally Funded Contracting: An Overview of the Law, Congressional Research Service 16 (2011).

⁵⁸ Formerly, labor surplus area concerns were also eligible for price preferences, set-asides, and subcontracting programs.

agencies for the "blind or severely disabled;" requirements procured through or accepted for the 8(a) Program must be released by SBA before they can be awarded through the HUBZone program

In addition to these government-wide preferences, there are other location-based preferences that are agency specific for "local private, nonprofit, or cooperative entities" under the Department of the Interior, Environment, and Related Agencies Appropriations Act of 2010.⁵⁹ However, despite the enumerated programs, local construction firms – whose location should prove a competitive advantage – continue to face difficulties.

III. Issues Before the Subcommittee

1. Contract Bundling

The Subcommittee will examine what steps can be taken to prevent unjustified bundling, better mitigate justified bundling, and hear testimony from industry that supports why and how the definition of bundling needs to be legislatively expanded to include new construction. This hearing further supports the recently introduced contract bundling legislation that will, among its many goals, expand the definition of bundling to include new construction; impose a \$2 million review threshold for all agencies; require publication of the bundling justification; and improve the review process for reviewing performance of bundled contracts before recompetition.

2. Sealed Bidding and Negotiated Contract Awards

The Subcommittee is aware of the positive and negative benefits of bid listing and will hear testimony that will include particular instances where bid listing has occurred and how bid listing can prevent bid peddling. The Subcommittee will consider whether legislative action should be taken to address bid shopping and bid peddling, or whether industry regulation is sufficient. Specifically, the Subcommittee is interested in hearing from GSA as to whether bid listing still presents the same challenges identified in the 1983 revocation of bid listing provisions given the added levels of transparency incumbent on prime contractors using subcontractors. Prime contractors are now required to report all subcontracts over \$25,000 through the Federal Subcontracting Reporting System which was created by the Federal Funding Accountability and Transparency Act.⁶⁰ Information is also reported into the Electronic Subcontracting Reporting System and that system tracks information on all other-than-small businesses subcontracting achievements. SBA Subcontracting Network requires that prime contractors publish any subcontracting opportunities over \$10,000 through a publication known as Commerce Business Daily,⁶¹ now called Federal Business Opportunities - a website that provides all prime contract opportunities over \$25,000 at www.fbo.gov. The Subcommittee would also like to know if the prime and subcontractor reporting requirements will eliminate the need for bid listing and minimize the use of bid peddling in the construction industry.

3. Credit for Subcontracting Goals

At this hearing, the Subcommittee will receive testimony on whether prime contractors should receive credit for lower tier subcontracting on individual subcontract plans. This hearing also supports the proposed subcontracting goal legislation that seeks to allow prime contractors, with contract specific

⁵⁹ 123 Stat. § 2904 (2010).

⁶⁰ Pub. L. No. 109-282, 120 Stat. § 1186 (2006). FFATA required that all prime contractors and prime grant award recipients report any subcontract or subcontract executed.

⁶¹ 15 U.S.C. § 637(d)(8)(k).

subcontracting plans, to take credit for all tiers of small business spending to further incentivize the use of small businesses at all tiers.

4. Prompt Payment

Prompt payment to prime contractors and subcontractors frees up capital and allows businesses to compete for other federal government opportunities. Given that the prompt payment provisions currently in place do not account for the high material and labor costs inherent in construction contracting, and that even the current reporting requirements fail to catch bad actors in timely manner, the Subcommittee will examine ways to protect small business construction contractors at the prime and subcontract level. Specifically, architects, who are typically small businesses that support construction projects, are paid within 30 days not 14 days as offered to other small businesses. Under 48 C.F.R. 32.904(c)(1)(ii) the due date for progress payments for A&E contracts is thirty days. Under 48 C.F.R. 32.904(d)(1)(i), construction professionals are guaranteed payment of their “proper payment request” within fourteen days. Architects often subcontract additional services, like structural engineering, when designing buildings, and are required to give the federal government 16 additional days for payment. When payment is delayed, both the prime contractor and subcontractors are harmed because the prime is unable to pay their subcontractors. To achieve payment uniformity for all small businesses, the Subcommittee will hear testimony that supports the rationale for changing payment days from 30 days to 14 days for A&E contractors to help support small businesses in payment terms and improve their cash flow.

5. Retention

Federal agency COs do specify a set percentage to be retained from the prime contractor for contract performance related issues, but do not specify an amount for the prime contractor to retain from the subcontractor. The prime contractor’s retainage from the subcontractor is discretionary; however, prime contractors tend to pass on the same percentage withheld by the government. The Subcommittee wishes to receive testimony on whether retention remains necessary in federal construction contracting or if the retention practices need to be clarified and standardized, and the extent to which surety bonds could or do alleviate this burden. Additionally, the Subcommittee will consider the necessity of a legislative change to prescribe appropriate retention percentage flow down requirements from the prime contractor to the subcontractor.

6. Surety Bond Program

The Subcommittee hopes that the SBA’s testimony will shed light on its experiences during the period of increased bond thresholds, and would welcome any recommendations the agency can provide to improve the program or address declining surety participation. The Subcommittee is also interested in learning about GSA and USACE’s experiences when dealing with small concerns that require bonds. According to the SBA Surety Bond program manager, increasing the surety guarantee to 95% did not increase the cost of the program, so the Subcommittee may explore industry’s proposals to increase the SBA guarantee percentages to 95 percent of the bond amount for 18 months and 90 percent thereafter. Additionally, the Subcommittee will consider industry’s proposals to address adjudication of claims by sureties seeking to have guarantees honored, improvements to data collection related to the program, and the affect of inflation and inflationary measures on the programs. Finally, the hearing will examine H.R. 3534, the Security in Bonding Act of 2011 and the protection this proposed legislation seeks to provide small businesses when using individual sureties, and the challenges small businesses face from disreputable sureties.

7. Locality Preferences

Considering that locally available materials and traditional building techniques are generally cheaper and better adapted to local conditions, it is surprising that local construction companies are not more competitive. This raises questions about the market research conducted by agencies into the types and levels of construction technology available, conditions of site, geography, slope, time constraints, availability of labor and raw materials, construction equipment and other related factors. However, while agencies can conduct market research to determine if there are local resources available to meet the government's needs to allow for maximum competition, they cannot specify a locality preference unless it is covered under a current statutory authorization lest they violate the Competition in Contracting Act.⁶² Therefore, the Subcommittee will examine whether a locality preference is desirable, how locality could be defined, and how such program could be implemented.

IV. Conclusion

Given that the federal sector is an extremely vital part of the construction market, legislative and policy changes may offer opportunities to correct and clarify contracting requirements to further maximize small business participation in construction contracting which leads to business growth and job creation.

⁶² 41 U.S.C. § 253.