

U.S. ARMY CORPS OF ENGINEERS

DEPARTMENT OF THE ARMY

TESTIMONY OF

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BEFORE THE**

**COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
UNITED STATES HOUSE OF REPRESENTATIVES**

ON

**CONSTRUCTION CONTRACTING AND THE BARRIERS THAT OFTEN
PREVENT SMALL BUSINESSES FROM EFFECTIVELY
PARTICIPATING ON CONSTRUCTION PROJECTS**

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

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

My testimony will address the Corps successes and challenges with helping small businesses obtain construction contract awards. I will also discuss local job creation, Miller Act surety bonding, contract payments, subcontracting credit, contract bundling, and the use of sealed bid versus negotiated procedures.

Small Business Construction Contract Awards

The Corps relies on small businesses to help us meet our military and civil works missions around the world. However, the Corps sees small businesses impacted by their internal challenges and barriers to being awarded construction contracts. I will discuss some of these barriers today. The Corps is committed to the continued success of its small business program.

During Fiscal Year (FY) 2011, the Corps had an overall prime contract small business goal of 35 percent. The Corps exceeded its small business contracting goal by awarding over 42 percent of all prime contract dollars to small businesses for a total of

over \$8 billion. Of this \$8 billion, we awarded approximately \$3.3 billion directly to small businesses for construction projects.

The Corps consistently looks for ways to improve processes and minimize barriers to help small businesses compete for contracts. One simple yet significant improvement is increasing the visibility of our pending procurements through early acquisition forecasting. Small businesses need time to prepare proposals and develop teams for major procurement opportunities. Procurement forecasts are critical tools that small businesses use to plan early and position themselves for success. We are providing early forecasts on our websites, at industry events, and via email for inquiring small businesses. Our small business advocates, contracting chiefs, and small business leaders meet no less than quarterly to discuss forecasts and opportunities for setting aside projects for small businesses.

The Corps is actively evaluating small business participation in construction source selections exceeding \$1.5 million, in accordance with FAR Subpart 15.304 and the DoD Source Selection Procedures. These procedures allow for proposals to be evaluated more favorably if prime offerors have binding agreements with small business subcontractors, and that meet or exceed the stated subcontracting goals of a particular procurement. The Small Business Jobs Act also assists in better enforcement of and actual use of the subcontractors stated and evaluated in the proposal.

I would like to discuss some of the barriers internal to small businesses that the Corps has witnessed:

Failure to Influence the Acquisition

Small businesses often miss the opportunity to influence acquisitions when they fail to respond to “sources sought” synopses. These synopses are used by the Government to determine whether or not procurements should be solicited full and open, or on a restricted basis for small businesses only.

The Federal Acquisition Regulation (FAR) requires contracting officers to set-aside each procurement that is valued under \$150,000 automatically and exclusively for small businesses unless the contracting officer determines there is not a reasonable expectation of obtaining offers from two or more responsible small business concerns that are competitive in terms of market prices, quality, and delivery. In addition, any procurement not set aside for small business is also coordinated with the Small Business Administration (SBA) Procurement Center Representative (PCR) that is assigned to that facility. In those instances where procurements cannot be set aside, our small business advocate works with the SBA PCRs to maximize subcontracting opportunities for small businesses.

For procurements over \$150,000, Corps small business advocates sit side-by-side with Contracting Officers and Program Managers to determine if there is a reasonable expectation that two or more responsible small businesses will submit an offer at a fair market price. This is referred to as the “Rule of Two.” When market research validates small business capability, contracting officers are required to set-aside acquisitions over \$150,000 for small businesses.

Market research to validate the “Rule of Two” is done through a variety of methods, but the most effective method is a sources sought synopsis on the Federal Business Opportunities web page. The purpose of the “sources sought” synopsis is to request information about the capability of small business firms. Typically, the synopsis requires small businesses to respond to a handful of questions and provide information about their technical capabilities and experience. Small businesses have a set number of days to respond. When two or more capable firms are identified, the FAR requires the solicitation to be set-aside exclusively for small businesses. However, small business advocates cannot recommend setting solicitations aside exclusively for small businesses if market research does not validate small business capability and interest.

Many small businesses focus their efforts on marketing face-to-face at outreach events and meetings with contracting officials and program managers without targeting a specific acquisition. There is significant value in face-to-face relationship building techniques. However, this is ineffective in actually winning contract awards. The most important and effective marketing technique is responding to the “sources sought” synopsis for upcoming solicitations.

Many small businesses are simply unaware of the significance of a “sources sought” synopsis, and this creates a barrier for getting the work set-aside exclusively for small business competition. Some small businesses consider the nature of sources sought synopsis to mean that it is too late to market for and participate in a particular procurement. Some are hesitant to respond, concerned that their technology or solution would be included in the final version of the solicitation and made available for other competitors to learn of a perceived competitive advantage. These concerns are unfounded. A sources sought synopsis does not seek an offer or bid and does not solicit proprietary information. Rather, it is a way for contracting officers to perform market research, verify requirements, validate an approach to a solution (e.g. subcontracting goals), ensure industry interest and capability, and ensure competition. Small businesses miss the opportunity to influence the acquisition strategy when they fail to respond to sources sought synopsis. Of course small businesses may bid or propose on acquisitions that are not set-aside exclusively for small businesses, but the potential for success is maximized when the procurements are set-aside for small business competition only. Small businesses must look for these opportunities on the Federal Business Opportunities website, determine if they have the experience and financial capability to handle the work, and then target their marketing efforts directly for specific procurements.

Failure to Focus on Technical Capability

Small businesses experience barriers to competing when their marketing is focused on their small business certification instead of their capability. Effectively marketing their

capabilities is key to influencing the acquisition. Small businesses must be diligent about pursuing work that aligns with their experience, past performance, and financial capability, and market those capabilities. Our customers expect us to minimize risks to their projects by making contract awards to the most experienced, capable, and financially sound firms. For negotiated procurements, evaluation teams weigh proposals for the optimum mix of experience, capability and financial soundness that result in contract award to the offeror deemed most capable of delivering a project on schedule and on budget for either best value or lowest price technically acceptable requirements. Having 8(a) and other small business designations is definitely an advantage, but it never takes precedence over demonstrated capability to perform.

Inexperience with Responding to Solicitations

Small businesses experience barriers when they do not take advantage of the many organizations dedicated to teaching small businesses how to navigate the federal procurement process. Firms must clearly understand what is required in the solicitation in order to respond in the correct format and with a winning solution. Organizations like Service Corps of Retired Executives (SCORE), Procurement Technical Assistance Centers (PTAC), and Minority Business Development Centers (MBDC) walk small businesses through the procurement process through training and mentoring. It is imperative that small firms that have yet to receive their first federal contract connect with these agencies to help focus their efforts in a way that would more likely result in contract awards. Many of these services are provided at no-cost to small businesses.

For negotiated procurements, small businesses must look for ways to make their proposal stand out by applying creative ideas to express capability and technical strength. One possible technique used by proposal teams is to have a separate team review the proposal against the solicitation requirements prior to submission, or for teams from very small companies to have individuals review elements of proposals written by others on the team. Review teams can increase the potential for success, because they objectively review whether or not the proposal effectively responds to the

Government's needs. Small businesses must keep in mind the Government's right to award without negotiations and discussions, even in negotiated procurements, so it is very important that the initial proposal represents the best possible technical proposal at the best possible price – there may not be an opportunity to submit a revision.

Small businesses can also learn to minimize the barriers related to mistakes and incomplete proposal submission through debriefings. Unsuccessful offerors should consistently request proposal debriefings. Offerors may request a debriefing to discuss the evaluation of their proposal in comparison with the requirements of the solicitation. The debriefing can provide critical information necessary to improve future proposal submissions.

The Corps Commitment to Minimizing Barriers for Small Businesses

Across the Corps, we are successful in helping to minimize barriers for small businesses, and our success is reflected in our small business program achievements. We will continue to commit to educating small businesses on how to influence acquisition strategies by responding to sources sought synopsis; the importance of focusing on technical capability, past performance, and experience; and the value of taking advantage of organizations that provide more in-depth counseling and training on how to navigate the federal procurement process and how to effectively respond to requests for proposals.

In FY2010, there were 42 protests lodged with the Government Accountability Office (GAO) against Corps construction project solicitations. In FY2011, protests to GAO for construction projects totaled 36. The Corps Small Business Office initiatives for FY2012 include analyzing the various small business related protests to determine if there are systemic issues relative to how we do business with small firms. Procedures will be reconsidered as we analyze the protests and the impacts on our procurements and the small business industry.

Local Job Creation

The nature of construction contracting fosters the participation of local subcontractors to execute the majority of the construction in most projects. The added expense to bring in non-local subcontracting teams, when local capability exists, adds unnecessary expense and significantly reduces overall profit to the prime contractor. Prime contractors generally must self perform 15 percent of the work, with up to 85 percent allowed to be subcontracted to local, regional, or national firms, who in turn rely predominately on the local labor market to provide both skilled and unskilled labor. It is common practice for prime contractors to hire local labor obtained through union hiring halls or local employment agencies.

Miller Act Surety Bonding

Pursuant to the Miller Act as implemented by Regulation, before a construction contractor is allowed to start work on a contract of more than \$150,000, it generally must furnish performance and payment bonds. A performance bond with a surety satisfactory to the contracting officer is required in an amount the contracting officer considers adequate for the protection of the Government. Generally the penal amount of the bond is 100 percent of the contract price. A payment bond is also required for the protection of all persons supplying labor and material. The amount of the payment bond is the same as the amount of the performance bond.

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

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

Sureties make money through volume, not by taking risks. Solid relationships with sureties and brokers remain the key to any construction companies attempting to obtain bonds. It is important for contractors to sell the job, sell the risk, sell the rationale for the pursuit, and the credibility of the construction company.

A limited amount of financial firms in the surety market could present barriers for small businesses. The surety market is effectively controlled by fewer than a dozen companies (fewer for environmental contracting). This limited presence of market providers present small companies with financial challenges, such as bonding availability, pricing and risk evaluation.

Contract Payments

The Corps is proud of its payment record, with 98.5 percent of all payments made timely in FY2010 and FY2011.

Corps construction contracts require certification from the prime contractor that it has paid its subcontractors from prior invoices and will pay its subcontractors from current invoices upon submission of a "proper invoice". Construction contractors generally invoice monthly and the Corps is required to make progress payment within 14 days of receipt of a proper invoice. Prime contractors are required to include prompt payment flow down provisions in subcontract agreements with subcontractors and suppliers at all tiers. Each subcontractor and material supplier at the first tier is required to be paid within seven days of receipt of payment from the Government or 21 days after receipt of a proper invoice by the Government. Second and third tier subcontractors are required to receive payment within seven days of receipt of payment from the next higher tier contractor.

The Government's privity of contract is with the prime contractor. In general, any payment dispute between a prime contractor and its subcontractors is handled privately and in accordance with the terms and conditions of that subcontract. However, there are some measures and provisions provided within the FAR to assist subcontractors'

timely receipt of payment. These include interest penalties for late payment, requirements to provide subcontractors the prime contractor's bonding company contact information, and the prospect of less than satisfactory performance evaluations of the prime contractor by the Contracting Officer.

Late progress payments could present a barrier for any business in terms of cash flow. However, the most common reason for delayed progress payments to the prime contractor and therefore its subcontractors is the failure by the prime contractor or its subcontractors to submit a proper invoice. Generally, defective invoices are the result of the lack of a valid prompt payment certification, failure to submit an approved schedule and failure to submit certified payrolls. The most common reasons the Corps makes payment but retains up to 10 percent of the earnings from the prime contractor are deficient construction or failing to make sufficient progress in accordance with the approved schedule.

Subcontracting Credit

The Corps' prime contractors have a high performance level in the award of subcontracts to small businesses. Our FY2011 data from the Electronic Subcontracting Reporting System (eSRS) reflects that Corps prime contractors awarded over 63 percent of all subcontracted dollars to small businesses. Our subcontracting goal for FY2011 was 50 percent, and our prime contractors exceeded this goal by an impressive 13 percent. Based on current regulations, prime contractors report subcontracting achievement on first tier subcontractors.

Contract Bundling

Small businesses have not encountered barriers due to bundling of Corps contracts. The Corps did not bundle any contracts for FY2010 and FY2011. Within the federal government, there is a clear distinction between the terms bundling and consolidation when applied to contracting. For construction projects, we secure approval from the

Head of Contracting Activity to consolidate construction projects on a limited basis only when determined and found to be in the overall best interests of the Government.

Army construction acquisition strategies may sometimes necessitate the need to consolidate projects into one solicitation. The Corps conducts market research to determine the best acquisition approach examining labor markets, the availability of supplier pools, economic forecasts, project complexity, and bonding requirements. After our market research indicates that consolidation is warranted, the Corps links suppliers to requirements with maximum consideration given to opportunities for small businesses. This includes consideration of fiduciary responsibilities to ensure proper stewardship of tax payer dollars and compliance with statutory and regulatory requirements to minimize the impact on small businesses.

Use of Sealed Bid versus Negotiated Procedures

When contracting by negotiation, the Corps has the flexibility to establish source selection criteria other than price. This gives the Corps the opportunity to select the contractor that is best qualified to meet a project's unique technical, schedule and budget performance requirements considering factors in addition to price. With sealed bids, we must select the lowest priced responsive bid from a responsible bidder. Sealed bid is the least used method for construction contracting, because it does not provide an opportunity to negotiate with the offeror.

Overall sealed bid procedures were used by the Corps to award 2,649 contracts valued at \$1.8 billion during FY2010 with preponderance of awards for FY2010 conducted using negotiated procurement procedures with 19,240 contracts awarded that totaled \$15.6 billion.

This trend of a higher volume awards using negotiated procurement procedures continued during FY2011 with 20,939 negotiated contracts awarded valued at \$11.4 billion in comparison with 2,821 sealed bid procurements valued at \$1.5 billion.

The same conclusions can be drawn from awards made to small business during FY 2010 and FY2011. During FY2010, the Corps awarded 1,776 sealed bid construction contracts to small businesses totaling \$767 million and 8,000 negotiated construction contracts valued at \$3.8 billion. In FY2011, the Corps awarded 1,854 sealed bid construction contracts to small businesses valued at \$363 million and 8,684 negotiated contracts valued at \$2.9 billion.

Table illustrating sealed bid versus negotiated contract data stated above is as follows:

FY10 & FY11 -- CONSTRUCTION CONTRACT AWARDS				
FY	Total # of Awards	Total Dollars	# of SB Awards	Small Business Dollars
NEGOTIATED PROCUREMENTS				
2010	19,240	\$15,618,104,053	8,000	\$3,819,912,045
2011	20,939	\$11,367,007,383	8,684	\$2,961,819,322
SEALED BID				
2010	2,649	\$1,822,273,186	1,776	\$767,879,011
2011	2,821	\$1,473,492,684	1,854	\$363,310,714

During negotiated procurements, the Corps encourages offerors to submit their best offer at the outset. The Corps source selection criteria require offerors to describe past experience and past performance in constructing similar projects. Once award is made, The Corps expects the key subcontractors identified in the proposal to be awarded subcontracts. Subcontracting plans are required when awards are made to other than small businesses demonstrating how subcontracting goals will be achieved. Contractors who request a change in proposed subcontractors after award must receive approval to do so from the contracting officer.

The Corps has experienced improved technical and schedule performance with negotiated procurements compared to sealed bidding because the contracting officer's award determination is based on best value through the consideration of factors such as technical, performance and small business participation, rather than solely on price. Negotiated procurements are more frequently used when the Corps defines projects in terms of performance expectations. In these cases industry is responsible for design and construction.

The Corps employs sealed bidding to a greater extent on Civil Works projects because of the nature of this work, which generally have no characteristics that can be used as discriminators. On prescriptive projects such as dredging, earthwork and mass concrete there is no benefit to the Government to attempt to establish source selection discriminators other than price. Many of our heavy/highway industry partners prefer sealed bidding over negotiated procurements for these type projects due to the transparency of the process and ease and simplicity of submitting a bid and making an award.

Sealed bidding is a common procurement method when our requirements are prescriptive and we issue fully detailed plans and specifications which the industry can easily price. This Design-Bid-Build strategy tends to result in more claims and changes and can be more adversarial than the Design-Build delivery system. In a Design-Bid-Build procurement, the Government effectively warrants its prescriptive design to be free of defects. Therefore any errors and omissions in the plans and specifications give rise to requests for equitable adjustment from the contractor. Because the prime contractor generally self-performs a small percentage of the overall work, the preponderance of change requests come from subcontractors at all tiers to the prime. This can result in acrimonious relationships between the prime and its subcontractors particularly when the prime must pass-through the request to the Corps. Furthermore, since we have no privity of contract with subcontractors, we have no way of knowing what the exact scope and terms and conditions of the subcontracts are, what scopes of

work are missing from the subcontractors' contracts, and what the exact nature of any disputes are between the prime contractor and its subcontractors.

The quality of the end product is affected by many factors, not just the use of negotiated or seal bid procedures. A sealed bid, based on fully developed prescriptive plans and specifications, can result in a very high quality end product and generally is the result of the project being well defined.

A negotiated procurement for a project articulated in terms of performance with a prescribed cost ceiling and prescribed (short) performance period may result in an end product that appears to be of "lower" quality. For example, the structural systems and finishes selected by the Design-Build contractor may be more consistent with commercial practices. However, the end product may exactly comply with the contractual technical and quality performance criteria articulated in the solicitation and as desired by the customer.

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