

Statement of

Mr. Dirk D. Haire of Fox Rothschild, LLP

on behalf of

The Associated General Contractors of America

to the

Subcommittee on Contracting and Workforce

Committee on Small Business

U.S. House of Representatives

For a hearing on

“Construction Contracting: Barriers to Small Business Participation”

February 9, 2012

AGC of America

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Quality People. Quality Projects.



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

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

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Statement of Mr. Dirk D. Haire
Fox Rothschild, LLP; Washington, DC
Subcommittee on Contracting and Workforce
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My name is Dirk Haire. I am the Managing Partner of Fox Rothschild, LLP's District of Columbia Office, where as I lead our national construction law practice, which is focused on federal construction. I regularly counsel federal contractors on small business teaming arrangements, including advice on affiliation and SBA's Ostensible Subcontractor Rule; mentor-protégé programs; small business and set-aside strategy and compliance (8(a) contracting, ANC, NAC, HUBZone, SDVOSB); small business subcontracting plan compliance; and small business size protests. I also current serve on the Executive Board of the Associated General Contractors of America (AGC), and currently Chair the AGC Federal Acquisition Regulation (FAR) Committee. I testify before the Committee on behalf of AGC and its members on the topic of small business utilization in federal contracting and potential reforms that may improve the government's efforts to utilize and develop small businesses.

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

Despite a recent modest upturn in construction employment, payroll employment in January 2012 was nearly 2.2 million, or 28 percent, below the peak in 2006, and unemployment in the sector remains deplorably high. The industry's unemployment rate in January 2012 was 17.7 percent, not seasonally adjusted—the highest of any industry and double the overall unemployment rate, according to data the Bureau of Labor Statistics released on February 3, 2012. Although demand for private nonresidential and multifamily construction has revived modestly, the outlook for public construction is grim as agencies at all levels of government continue to cut construction spending.

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

Our members recognize the potential benefits that federal small business programs – including the 8(a) Business Development Program, HUBZone Program, Small Disadvantaged Veteran Owned Small Business (SDVOSB) Program, tribally-owned contracting programs, and Woman

Owned Small Business Program – provide to contractors who qualify for these programs. However, the programs as currently regulated, do not achieve the important goal of developing successful companies that can compete and succeed on their own. In AGC’s view, the rules need to be reformed so that: (1) contractors may both comply with the rules and meet the requirements of the customer more efficiently, and (2) contractors may reasonably predict what actions are compliant with the rules. AGC believes that the current rules encourage firms to structure their performance in a way that technically meets legal requirements yet fails to capture the spirit of the small business programs. Additionally, many of AGC’s members, and many of my clients, find the rules difficult to understand as they are currently written. For these reasons, AGC proposes: (1) that agency small business utilization goals be revised, and not increased, so as to secure more meaningful, achievable utilization of small businesses, (2) SBA work with federal agencies and industry groups to devise safe harbor standards for contractors who attempt to meet SBA requirements in good faith, yet fail to achieve perfect compliance, and (3) the burden of meeting agency small business utilization goals be spread more evenly across all industries.

Contracting Reform

As the Committee considers the changing federal procurement landscape, AGC offers the following points for consideration before the Subcommittee today:

- The SBA and contracting agencies need to work together and consult with industry leaders to develop safe harbor standards. Having easy to understand safe harbor standards will encourage: (1) small business participation in the federal market, and (2) large businesses working with small businesses without the fear of inadvertently violating some unknown portion of the Small Business Act or SBA’s rules of affiliation.
 - As an example of a proposed safe harbor standard: AGC requests clear guidance for when the hiring of employees will make one business affiliated with another. Specifically, AGC requests clear guidance stating that the following scenario does not constitute affiliation: an employee, who used to work for a subcontractor, leaves his employment and becomes an employee of a prime contractor.
- AGC additionally proposes that SBA consult with federal agencies and industry leaders to develop more consistent and easier to understand affiliation rules. AGC has found that the current rules of affiliation are not easy to understand. They do not understand which factors contribute to a finding of affiliation. They also do not understand the “tipping point” where too many factors will make a large business and small business affiliated. Confusion over the affiliation rules cause businesses to file protests, which cost the government both time and money. Some of these protests may be avoided if all parties – the agencies, the SBA, and industry leaders – contribute to revising the SBA rules of affiliation to clearly state what is and is not prohibited.
 - AGC additionally proposes that a safe harbor standards be created to protect contractors who assist small businesses, believing they are complying with the rules, but may inadvertently violate the rules of affiliation.

- AGC also proposes that agency small business utilization goals be reduced, or at the very least, stay at their current levels. Although AGC applauds the government’s efforts to increase opportunities for small businesses, AGC believes that higher goals come at the expense of more meaningful small business participation. A higher percentage of small business contracting does not mean that small businesses are performing more work on average. Instead, it provides more opportunities for businesses to abuse the small business programs. Agencies lose the ability to successfully monitor the current set-sides and related efforts to involve small businesses when they are required to solicit more. Without vigilant monitoring, the government has no way of knowing that small businesses will actually perform primary and vital work. This is especially disconcerting given that many companies making a good faith effort to comply cannot do so because of the complexity of the current regulations. Contractors need more, not less guidance to comply with program requirements. Contractors will not receive this guidance if agencies are required to focus on a higher volume of small business utilization.
 - AGC strongly suggests that the government utilize its current technology and allow contractors and contracting agencies to count lower tier subcontracts as contracts to small businesses. This will provide a more accurate picture of how small businesses are used to complete federal projects. This will also allow contractors to structure their subcontracts in a way that is closer to general industry practice, and is therefore, more economically efficient and less costly to the government, without sacrificing any small business participation.
- AGC also proposes that federal agencies only consider setting aside a contract to a small firm if the contract is less than 50 percent of the size standard in that industry NACIS Code. This will ensure small firms are awarded contracts that are executable by the firms themselves. It will also ensure smaller firms will succeed by not being burdened with contracts that are so large they would be at risk for defaulting on the contract or being forced to simply “pass through” the work to a larger firm at a lower tier.

Current Rules Do Not Optimally Encourage Small Business Participation

AGC believes that current rules governing small business programs allow firms to structure their performance in a way that minimizes true small business involvement and development yet technically operates within the bounds of the law. AGC does not believe this achieves the true intent of these programs, which is to maximize small business development. Additionally, the current regulations requiring agencies to meet certain, set percentages of small business utilization, unfairly requires agencies to choose between coming short of meeting their goals or risking SBA rule violations.

My construction clients attempt to follow SBA rules and regulations in good faith. However, they sometimes fall short of perfect compliance because the rules are not clear or they conflict with the rules yet meet the requirements of their customer.

For example, I represent one client that could not meet the requirements of the customer yet comply with the HUBZone set-aside requirements of the contract. My client was a non-

HUBZone subcontractor on a HUBZone set-aside contract. The HUBZone prime contractor had little experience performing the type of work required by the contract. Therefore, the HUBZone prime contractor subcontracted a significant portion of the work (more than 85 percent) to my client. The HUBZone prime contractor represented to my client that both the 50 percent and 15 percent self-performance requirements for the contract, codified in two separate sections of the Code of Federal Regulations, were waived by the contracting agency. The HUBZone concern interpreted this to be the instruction of the contracting agency. After reviewing the contract and solicitation information, I could not find that the 15 percent requirement had been waived for the contract. Fortunately, the contracting team had not performed the majority of the work, and the HUBZone concern had the opportunity to devote more of its own labor to the project to meet the 15 percent requirements of the contract. However, had my client not brought this matter to my attention, both the HUBZone concern and my client may have violated an SBA regulation that required at least 15 percent HUBZone performance on the contract. As a result of the direction from the agency and the confusing language of the regulations, both the HUBZone concern and my client expended additional amounts reforming their subcontract agreement and the agreements for lower-tier subcontractors. We anticipate that these costs will be submitted in a claim to the contracting officer.

The additional costs and efforts would not had been required had the parties understood the SBA HUBZone Program requirements. The contracting agency provided a good-faith interpretation of the rules. The agency's interpretation was provided so that the HUBZone concern could perform the work as a prime contractor; yet ensure that the agency's needs for a timely, quality end product were satisfied by an experienced party. However, despite all parties' good faith efforts to meet the contract requirements using a small business, the agency's interpretation did not comport with the Code of Federal Regulations requirements for the set-aside. Had the regulation been more straightforward, any confusion may have been avoided. Alternatively, had this project been bid as an unrestricted procurement, the agency's needs may have been better satisfied for less money.

Additionally, agencies concerned with fraud in small business programs may over-correct, so as to deny opportunities to legitimate small businesses. The U.S. Government Accountability Office (GAO) has repeatedly reported the problems of agency monitoring their set-aside programs, including the HUBZone program, the super-preferences afforded to Alaskan Native Corporations, and the newest preferences created for Service Disabled Veterans and Women Owned Small Businesses. Agencies looking to avoid criticism, but required to keep utilizing these programs at high levels, may unfairly exclude some businesses that do qualify for the program for minor technicalities in the contractor's paperwork or the government's processing of that paperwork. For example, on November 30, 2011, the U.S. Government Accountability Office (GAO) issued a report stating that the Department of Veterans Affairs (VA) could do more to reduce the SDVOSB Program's vulnerability for fraudulent certifications. *See Additional Improvements to Fraud Prevention Controls Are Needed*, GAO-12-205-T (Nov. 30, 2011). After GAO issued the report, I represented several clients in VetBiz delisting matters. My clients are service-disabled veterans who own businesses that qualify for inclusion in VetBiz. Yet the VA delisted them from VetBiz and therefore prevented them from receiving contract awards for a period of time. Although the VA should take actions to avoid fraudulent certifications, the VA should not respond to criticism by overcorrecting and delisting concerns

that are clearly eligible SDVOSBs. Doing so hurts small businesses and prevents federal agencies from meeting their goals.

Reform Small Business Utilization Goals

As I previously noted, there is an incredible amount of pressure on contracting officers to meet agency-wide goals. This pressure is increasing. It is proposed in a pending bill that senior executives within a contracting agency shall not receive any incentive awards, or bonuses, if that agency fails to achieve its yearly small business utilization goal (*See H.R. 3850*). This proposed legislation unfairly penalizes agency officials for matters beyond their control. Not every small business is well-suited for every contracting opportunity. Requiring agency officials to meet goals regardless of whether the offering small businesses are capable of performing the work is unfair to the agency officials, the awardee, other contractors, and the public. It is unfair to the public because the public receives inferior work at a higher price when the agency is forced to award a contract to an unqualified firm. Additionally, the small business awardee does not benefit from being placed in a position where it cannot satisfy the contract requirements. Taking on a large contract, too fast, may have the unintended effect of bankrupting a small business. Additionally, when a small firm finds itself unable to complete the work on a contract it was never qualified for, the firm must subcontract the work to a large firm to perform the vast majority of the work. This does not serve the intended purpose of the Small Business Program - "to maintain and strengthen the nation's economy by enabling the establishment and viability of small businesses and by assisting in the economic recovery of communities after disasters" - at all. The federal government must ask itself a simply question: What is more important – Help small firms thrive in all industries or meet the goals by any means necessary?

Furthermore, the small business utilization goals overburden some industries. The construction industry has historically supported and provided opportunities for small businesses. The industry is proud of its efforts to include small businesses and allow small businesses to develop. Instead of being rewarded for its efforts, agencies over rely on the construction industry to shoulder the burden for other industries that have not encouraged small business involvement. Agencies try to meet their entire goal by limiting competition almost only to small businesses in construction. In effect, this industry is penalized for their successes encouraging diversity.

A consequence of this practice is causing another disturbing trend: Massive growth in the percentage of small business subcontracting goals. In some cases, we have seen the small business subcontracting goal requirements exceed 70 percent and have gone as high as 90 percent even on projects well in excess of the small business size standard. Large prime contractors are usually able to meet the strict legal requirements to achieve these goals, but only through a combination of complicated project administration maneuvers and substantial use of lower-tier subcontracting to larger businesses. These techniques, while legal, do not help most small business and serve primarily to increase the cost of construction to the taxpayers. Rather than force unrealistic goals on very large projects where an extremely high level of small business subcontracting is simply not feasible, the government should adapt its agency-wide goals and subcontracting goals to be more consistent with what the market can provide. This might be an opportunity for the government to break up such contracts into smaller ones so that small businesses will be better positioned to compete and execute contracts with greater success.

Count Subcontracting At All Tiers

We thank the Committee for recognizing the need to begin to address the issue of allowing prime contractors to receive credit for fully reporting subcontracting activities at all tiers. Current SBA rules require that large business contractors keep track and measure the actual flow of dollars to small business subcontractors on federal construction projects. However, the current rules do not take into account the actual amounts that flow down below the first tier level of subcontracting. Within the construction industry, the bulk of the work is performed by subcontractors who in turn hire second tier and third tier firms to perform elements of the project. Under the current system, if an “other-than-small” business serves as a first-tier subcontractor, the prime contractor is not asked to report further dollars that are going to small businesses below the first tier subcontractor. This is because the contracting agency is not allowed to take credit for those dollars towards its goals. Unfortunately, this gives an incomplete picture of true small business participation.

Allowing prime contractors to report small business subcontracting at all tiers would more accurately measure small business participation. Allowing for reporting at all tiers would also allow agencies to more easily meet their small business utilization goals. Allowing for reporting at all tiers would finally allow prime contractors to structure their subcontract arrangements in the way that is most sensible and cost-effective, instead of having to structure their subcontractor choices around the reporting requirements.

One example why this is a problem for prime contractors and the government and how our recommendation can help bring greater transparency to subcontracting goals is the following:

- An agency procures a \$100 million building to be constructed. One of the first tier subcontracts is for all the mechanical work to be performed in the structure. The subcontract is valued at approximately \$12 million and the electrical subcontract is approximately \$15 million. This is simply due to the size and scope of the facility to be built. Unfortunately, both subcontracts are simply too large for a small business.
- The total dollars available for subcontracting opportunities is approximately \$75 million. With a small business subcontracting goal of 77 percent, this translates to \$57,750,000 awarded to small business concerns, just short of \$7,750,000 short of attaining the goal. The current law prevents the prime contractor with the ability to count any of the work beyond the first tier because if the first tier subcontractors are large, the counting and reporting stops right there. That is true even though both the mechanical and electrical subcontractors will purchase materials and subcontract to 2nd and 3rd tier levels, and that work will never get counted. The problem is compounded further among subcontracts for specialty trades for which there are no qualified small businesses are included, such as skylights (\$1 million), precast (\$2 million) and structural steel fabrication (\$4 million).

The technology for reporting subcontracting data at all tiers is already available and used by the federal government. The system already used to report subcontracting data, the Electronic Subcontractor Reporting System (eSRS), is capable of tracking and reporting small business

subcontractor data on multiple tiers. Unfortunately, current rules do not encourage prime contractors and their subcontractors to account for total small business participation at all tiers. AGC recommends that Congress legislate to allow contractors to count small business involvement at all tiers for purposes of meeting subcontracting goals and agency small business utilization goals.

Contract Bundling

Another major challenge for contractors over the past several years is how federal agencies have addressed the consolidation of multiple construction contracts into a single contract. From our members' perspective, the utilization of Multiple Task Order Contracts (MATOCs) or Multiple Award Construction Contracts (MACCs), as they have been called, fit within the parameters of contract bundling. These types of contracts may not meet the legal definition of "bundling" per se, but they have the practical effect of serving as de facto bundled contracts because these contracting vehicles include more than one "task" that can easily be contracted out under a separately procured solicitation. Increasingly, the federal government is awarding ever-larger contracts for public works and infrastructure projects. These mega-projects reduce bidder competition and aggregate project risk, and may challenge surety capacity, sometimes necessitating percentage or partial bonds instead of bonds covering 100 percent of the contract price.

One of the major reasons bundling on construction contracts has proliferated is that there is currently no provision in federal law that requires construction contracts be reviewed for a bundling determination. Consequently, agencies are able to avoid having to do any sort of economic impact analysis for a contract that would otherwise meet the definition for "bundling" simply by adding a component that small businesses are not performing to the contract. A revision to the definition would clarify that contract bundling rules apply to construction procurements and that these procurements must be reviewed for any impacts on small companies. We are pleased to see that the legislation recently introduced will address this shortfall. The federal government needs to find ways to unbundle extraordinarily large construction projects, so more contractors can compete for these projects and so these projects are fully covered by the performance and payment bonds. Reducing government contract bundling would increase competition on federal procurements and would enhance benefits to the government and provide added opportunities for small businesses to obtain government construction contracts.

Local Geographic Preferences for Construction

AGC believes that local geographic preferences can in fact be more detrimental than beneficial, by encouraging retaliatory measures from other local surrounding jurisdictions. Many of our members have growing concerns that local preferences has have the effect of limiting small and local business participation; which is especially detrimental to the construction industry, which is comprised of many small businesses that typically are limited by geography.

Federal Acquisition Workforce

Recruitment, retention and training of the federal acquisition workforce is critical to the successful execution and completion of construction contracts. As you can already see from our concerns about contract bundling, an understaffed federal acquisition workforce is suffering from the pressures of an already challenging procurement environment. The shrinking acquisition workforce is an ongoing problem and will exacerbate as the number of procurements continues to grow.

There are two simple facts that raise our concerns in this area: 1) In fiscal year 2011 alone, the government purchased approximately \$720 billion in goods and services, and 2) one federal acquisition professional in eight already is eligible to retire, and that will rise to more than half the workforce by 2016. The average retirement eligibility for contracting professionals will increase from 29 percent in FY 2011 to 50 percent in FY 2016.

We fear that the federal government workforce challenges may only get worse in the coming years. In order for the government to meet its many missions, it will have to do a better job of recruiting, hiring and training new employees. Given that the government's purchase of goods and services is at an all time high, it is essential that the government acquisition positions be fully staffed. This problem needs to be addressed in the near-term to avoid the negative ripple effects that a strained workforce can have on all facets of contracting.

Agency Consistency

As a matter of policy, AGC recommends that agencies with large regional offices continue to work to promote the implementation of uniform agency policies that will provide greater consistency in the construction process. Many of our members have repeatedly found wide variances in regional operations, contract administration and administrative practices. Such inconsistencies can produce serious administrative and communication problems and can discourage contractors from continuing to work in the federal market. We recognize that the federal agencies have worked very hard to ensure consistent communication and consistency between regional offices over the past several years and hope that trend continues into the future.

Conclusion

Thank you for the opportunity to provide our views on working with the federal market. AGC strongly recommends Congress reform the federal procurement process to: (1) create safe harbor standards that do not penalize contractors for making good faith efforts to abide by SBA rules and regulations, (2) limit overreliance on construction to achieve overall agency small business contracting goals, and (3) ensure that small business goals take into consideration actual small business capacity in relevant specialties. Requiring higher-and-higher agency small business utilization goals will not result in stronger small businesses. Instead, agencies should focus on monitoring current small business work to discourage fraud yet ensure that legitimate small businesses are not excluded from competition. Counting all small business participation, at all contracting tiers, will provide a more accurate picture of small business usage and not force small businesses to bid on contracts that far exceed the relevant small business size standard.

AGC believes these reforms will encourage the development of successful and enduring small construction businesses. AGC believes that this should be the goal of all small business programs. In addition, we strongly believe that agencies need knowledgeable procurement officers to navigate the complexity of the construction process and to ensure success in all aspects of procurement and project delivery. In the end, supporting small businesses is the responsibility of all industries, and the government should not rely on meeting arbitrary goals at the expense of a few industries that already do a good job of supporting small businesses.

We believe this market offers tremendous opportunities for both construction contractors and the federal government. AGC looks forward to continue working with the Subcommittee and the full Committee on these critically important issues.