

BARRIERS TO SMALL BUSINESS PARTICIPATION

HEARING

BEFORE THE

SUBCOMMITTEE ON CONTRACTING AND
WORKFORCE

OF THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES

HOUSE OF REPRESENTATIVES

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SECOND SESSION

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CONSTRUCTION CONTRACTING: BARRIERS TO SMALL BUSINESS PARTICIPATION

THURSDAY, FEBRUARY 9, 2012

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE,
Washington, DC.

The Committee met, pursuant to call, at 10:45 a.m., in room 2360, Rayburn House Office Building. Hon. Mick Mulvaney (chairman of the subcommittee) presiding.

Present: Representatives Mulvaney, West, Hanna, Chu, Schrader.

Chairman MULVANEY. I apologize in advance on behalf of myself and Ranking Member Chu for being 44 minutes late. But at least this way we will not be interrupted by votes. And we do hope that we will have other members of the Committee, Subcommittee, coming and going. But we are going to go ahead and get started now.

We are here today to discuss the impediments that small businesses face when competing for federal government construction contracts. The federal sector is an extremely important 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 an average of about 20 percent in the prior decade. However, in our current economic climate, the construction industry faces extremely low profit margins and an incredibly high rate of unemployment. It was over 18 percent just last month, which is, as high as that is, the lowest the unemployment rate has been for the last two years. Against that backdrop, we have regulatory requirements of the federal contracting process that are costly, burdensome, and often prohibit small businesses from successfully competing on contracts, especially construction contracts. This is not satisfactory.

You will hear testimony today that brings to the forefront issues that small businesses cope with on a daily basis: as prime construction contractors and subcontractors on construction projects, from numerous statutory and regulatory changes, to obstacles dictating how construction work will be solicited and awarded. For example, the bundling of construction requirements often prevents small entities from competing for contracts that only large entities have the resources to perform. However, as a former small home builder myself, I know that small construction companies have the resources and expertise to build in their communities at competitive prices.

We will also examine challenges involved with the sealed bidding methods of contract awards, the manner in which SBA calculates

the prime contractor's credit for subcontracting goals, the prompt payment of prime contractors and subcontractors on construction contracts, the government's retention of contract payment on some construction contracts, and the desirability of having a local preference in some circumstances for construction contracts. Finally, we will address the effectiveness of the SBA's Surety Bond Program and take a look at the individual surety bond market's role in securing bonds for government contracts.

The testimonies today should help the Committee determine if legislative changes or policy clarifications are needed to further maximize small business participation in construction contracting. I would like to thank everybody for being here today. We look forward to your testimony on construction.

At some point during the day we hope to have two nonmembers of the Committee participate, the gentleman from New York, Mr. Hanna, and the lady from Washington, Ms. Herrera Beutler. And if there is no objection we will allow them to sit today.

With no objection being heard, we will do that assuming they show.

So for that, before we begin, I will turn to the Ranking Member for her opening comments. Ms. Chu.

Ms. CHU. Thank you, Mr. Chairman.

In recent months, the nation has finally seen some enduring glimmers of economic hope. The unemployment rate has fallen for five straight months and the 3.7 million new jobs have been created over the last two years. In my home state of California, optimism is picking up as a measure of a state's economic activity is now 12 percent above its cyclical low. And while there is much progress that still must be made, these are promising developments.

Part and parcel to this recovery is the revival of the construction industry. According to the Associated General Contractors of America, year-over-year construction employment improved in 28 states last month, including California, which led the way to creating more than 21,000 new jobs. This is the largest such increase since November 2007.

While this is positive news, the truth is that the unemployment rate in the construction industry is more than 17 percent, double that of the total population. In fact, according to AGC, employment remains at 1996 levels. The reason is simple. Private sector spending, as well as that of state and local governments, has declined substantially over the last few years. Compounding this are several challenges that small businesses face in winning federal construction work.

Among these problems is the continued bundling of contracts. Last year more than 150 contracts worth over \$50 billion were consolidated. As a result, nearly 200 small businesses missed out on contracting opportunities worth more than \$15 billion. By bundling large contracts such as these, the government effectively shuts out smaller companies from competing for work that they have the skills and expertise to perform. Splitting these mega contracts into smaller pieces would enable more construction firms to participate in these projects. By doing so, the government would avail itself of

more qualified companies and the high quality craftsmanship that they bring to the table.

Another challenge that small construction firms face is receiving a surety bond which is required by the government and guarantees contractor performance. While the SBA operates a program to fill this gap, the agency found that only 1,000 of the 72,000 small construction businesses that are less than two years old used it last year.

Why is this? Small businesses cite too much paperwork and a guarantee rate that is not high enough as problems plague this initiative. These concerns, as well as those requiring the adequacy of bond sizes themselves are preventing small firms from competing for federal construction contracts.

While bundling and bonding are the most notable obstacles to small firms' participation in federal construction projects, other issues impede their involvement. Subcontractor protections are important in the bidding process as are requirements that all contractors, both primes and subs, receive prompt payment for their services. After all, many small businesses do not have the deep financial pockets of larger firms and need to receive payment to make payroll and pay their own vendors.

During today's hearing I am looking forward to hearing from both industry experts and agency officials on these matters. Ensuring that small construction firms can fully compete for federal contracts is critical, not just for them but for the country as this sector underpins much of our nation's economy. In light of declining private sector and state and local infrastructure investments, federal contracts have become increasingly an important source of revenue for small businesses. With such spending more than doubling over the last decade, the reality is that doing business with the federal government is no longer simply an option but rather a critical requirement for small firms' long term success.

Thank you, and I yield back.

Chairman MULVANEY. Thank you, Ms. Chu.

Just a couple of housekeeping matters. The way we work it in here is that when we ask you to begin speaking you will see a timer in front of you and the basic time allotment is five minutes. You will see a green light for four minutes and then the yellow light for the last minute. However, our practice, since we have been doing this this year, is to try and give you as much leniency as possible. Please do not feel the need to rush through your presentation. We are very interested. Many of you have come long distances. So we will give you as much time as you need. If for some reason you do start to get a little longwinded, which is not unusual in this room, mostly from us more than it is from you, you will hear me lightly tap the gavel and that is just an invitation to please start to wrap things up. And then what we will do is we will have everybody's testimony at one time and then we will turn to the members for questions.

STATEMENTS OF DIRK D. HAIRE, PARTNER, FOX ROTHSCHILD, TESTIFYING ON BEHALF OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA; ROSANA PRIVITERA BIONDO, PRESIDENT, MARK ONE ELECTRIC CO., INC., TESTIFYING ON BEHALF OF WOMEN CONSTRUCTION OWNERS AND EXECUTIVES; MARK MCCALLUM, CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS; MIGUEL GALARZA, PRESIDENT, YERBA BUENA ENGINEERING AND CONSTRUCTION

Chairman MULVANEY. So with that I will introduce some of the members of the first panel. We will start with Mr. Dirk Haire. He is the managing partner with Fox Rothschild and he practices in the area of construction law and government contracts. Mr. Haire is testifying on behalf of the Associated General Contractors of America, for whom he is the federal—excuse me, serves on the Federal Acquisition Regulation Committee.

Sitting next to him is Mrs. Rosana Privitera Biondo. She is the founding employee, now the president, of Mark One Electric Company. She is testifying as the President of Women Construction Owners and Executives. Welcome, Ms. Biondo.

Following her is Mr. McCallum. Mark McCallum is the chief executive officer of the National Association of Surety Bond Producers, an international association of companies employing professional surety bond producers and brokers.

And I will yield now to Ms. Chu for the introduction of our final panel member.

Ms. CHU. Thank you, Mr. Chairman, for allowing me to introduce Miguel Galarza, who is president of Yerba Buena Engineering and Construction, which is a multimillion dollar civil and environmental engineering firm. He successfully managed contracts for the U.S. Navy, the U.S. Army Corps of Engineers, the U.S. Air Force, National Park Service, as well as for the California Department of Transportation [CALTRANS]. Mr. Galarza has been honored by the Small Business Administration, the California Hispanic Chamber of Commerce, Ernst and Young, Inc. Magazine, and the Minority Business Development Agency. He received a B.S. in construction management and attended UCLA's Anderson School of Business and Dartmouth's Tuck School of Business.

Mr. GALARZA, I thank you for being here and I welcome you to the hearing.

Chairman MULVANEY. You should have him sit up here. Goodness gracious.

Mr. Haire, fire away. We will just go right down the aisle.

STATEMENT OF DIRK D. HAIRE

Mr. HAIRE. Thank you. Good morning.

Although I am in a private law firm, private practice representing contractors involved in federal small business issues, my testimony here today involves or is on behalf of the Associated General Contractors of America and their 33,000 member companies, many of which are small or closely held businesses. As you mentioned, Mr. Chairman, I am on a number of leadership roles in the AGC and an active member.

The federal government has many different programs and services to support small business contracting. Agency applauds this Subcommittee for holding today's hearing to examine ways to improve the delivery of federal construction services involving small businesses. AGC's members recognize the potential benefits that federal small business programs provide to contractors who qualify for these programs.

However, the programs as currently regulated sometimes do not achieve the important goal of developing successful small businesses that can compete and succeed on their own.

SBA's affiliation rule provides a good example of the challenge. In recent years, many federal agencies have increased their goals for small business participation in construction to the point where small businesses are regularly given the opportunity to compete for projects that stretch their resources and capabilities. While this can be very positive for growing a small business, these small businesses often need to subcontract some of the work to a larger business which may have more expertise or resources. One would think that SBA publishes a clear set of rules for affiliation so that contractors would know what they can and cannot do with respect to business relationships between small prime contractors and their large business subcontractors. That is not the case.

SBA polices the affiliation rule on a case-by-case basis with no set of safe harbors that contractors can rely on to know if they are in compliance or not in compliance. This ad hoc approach has thrown the construction industry into disarray when it comes to small business contracting issues. I have clients who routinely receive inconsistent advice on small business issues by different agencies, and even by different geographic offices within the same agencies. Agency believes that one way to solve this problem is to adopt a consistent set of safe harbor activities with respect to affiliation so that all contractors, large and small, know what they can and cannot do with respect to small business contracting issues.

The construction industry has historically supported and provided opportunities for small businesses and is proud of its efforts to include small businesses and allow small businesses to develop.

Consequently, agencies often 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, the construction industry has been penalized for their success encouraging the utilization of small businesses.

The same concern holds true for small business subcontracting. I routinely see solicitations for \$100 million and even billion dollar construction projects with small business subcontracting goals of 70 percent or more. Rather than force unrealistic subcontracting goals on very large projects where an extremely high level of small business subcontracting is simply not feasible. The government should adopt its agency-wide goals and subcontracting goals to be more consistent with what the market typically provides.

We thank the Committee for recognizing the need to begin to address the issue of allowing prime contractors to fully report and receive credit for small business subcontracting activities at all tiers.

This will increase transparency and demonstrate whether an agency has actually met its utilization goals.

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, the bundling issue. 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 to be reviewed for a bundling determination. Incidentally, from our members' perspective, the utilization of multiple award task order contracts [MATOC] or multiple award construction contracts, also known as MACs as they have been called, fit within the parameters—from our view fit within the parameters of contract bundling.

AGC thanks this Committee for its consideration of revising the bundling definition to clarify the contracting building rules apply to construction procurements and that these procurements must be reviewed for any negative impacts on small companies.

Another trend that we have seen at the state and local level is the proliferation of local geographic preferences. AGC believes that these preferences can, in fact, be very detrimental because they encourage retaliatory measures from other local surrounding jurisdictions and can have the effect of hurting small and local construction companies that typically are limited by geography.

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 the SBA rules and regulations, and specifically the affiliation rule; (2) limit overreliance on construction to achieve overall agency small business subcontracting goals; (3) ensure that small business goals take into consideration small business capacity in the relevant markets; (4) count all small business participation at all contracting tiers; and (5) revise the bundling definition to clarify that contract bundling rules apply to construction procurements.

Thank you. I appreciate the time.

Chairman MULVANEY. Thank you, Mr. Haire. And we are going to have several questions but we will go through all the testimony first and then come back one at a time.

Ms. Biondo.

STATEMENT OF ROSANA PRIVITERA BIONDO

Ms. BIONDO. Mr. Chair, Ranking Member Chu, and members of the Subcommittee. Good morning.

I am Rosana Privitera Biondo, president of Mark One Electric Company, headquartered in Kansas City, Missouri. Our company does both prime and subcontracting work. I can see the issues from both sides.

Today I am testifying in the capacity as president of Women Construction Owners and Executives (WCOE). Our mission is to create contracting opportunities for our members. Our members are women. We have just completed our 28th annual leadership conference here in DC, and we had women business owners from across the country discuss these important issues.

Let me begin with size standards. The SBA's size standards in construction are based on either revenue or number of employees. We at WCOE would like the SBA's office to change the process from revenue to number of employees. Here is why:

A small specialty contractor is capped at \$14 million revenue. Then once they exceed those numbers they are now a large company. Yet, a company that you may buy material supplies from may have revenue that exceeds that same \$14 million number, yet their company is not considered small—they are still considered small. And the reason they are still considered small is that they are done by the number of employees. So in this very avenue you have companies who have all types of dollar ranges that differ, yet number of employees seems to be a better way to calculate whether a company is large or small. So we urge them to look at calculating the size of a company based on number of employees.

Bid shopping—We need this to shop. This hurts women in all small businesses. We would like the agency to implement a process that on all sealed bids that the prime contractor would submit, that they would be required to list their major subcontractors by name, scope, and dollar value at the time of bid. This would eliminate the after-the-fact low bid substitution. This happens both in the private and public sector.

Example: I bid a job and on that day the general contractor comes back to me and says we used you on this project; you are the low bidder. Weeks go by; You never hear any more from them and then you are asked what happened? You are told, after-the-fact, that a lower bid came in and so they used that bid. So the question is at the time of bid, if this was the federal government, and I was low at the time of bid, did they use—they used my number. Where did that money go? Did the federal government get that savings? And it is just not a fair process.

So we would like to see, again, I will say it again, we would like to see on sealed bids that the majority subcontractors be listed by name, value, and scope of work. This would give the contracting officers the ability to police this through their contract process and this would help small businesses of all kinds.

WOSB, Women-Owned Small Business Program. They refer to this as 8M. This was implemented last year. This program is intended for restricted competition for women-owned businesses seeking prime contracts, very much like the 8A program and the service-disabled veterans program. This is not what we got. It is restricting our women to a \$4 million cap on the size of projects. That statistic shows that the \$4 million dollar value created by 165,000 projects, that the size of the contracts end up being \$118,000 for 165,000 procurements.

Well, companies that do \$118,000, may or may not make a few thousand dollars at the end of the day. That is not a way to grow new businesses, especially for women. The women have waited 11 years for this program to be enacted and then we are being capped right out of the chute. But the other two, 8A and service-disabled vets are not.

And just to give you some further statistics, contracts that are over the \$4 million value created about 2,125 projects with a base contract of \$16.6. This is what women need to grow their compa-

nies in order for them to become more successful; not this \$4 million cap. Now, we understand that this has already started to be addressed but we urge you to remove these caps.

Retention and bonding. In the federal government contracting, it says that retention is at the discretion of the contracting officer. We think that retention should only be held on work in question and nothing else. We feel that if a bond is in place, for sure no retention should be held as that is double dipping. The bond should protect the owner.

Bundling. Bundling or the grouping together of different requirements into one enormous contract. They may or may not—let me start over.

Bundling or grouping together of different requirements into one enormous contract means small businesses cannot compete as primes. They may or may not be getting subcontracting work but do not get prime work. However, the current unbundling rules do not apply to new construction contracts, so many small construction firms do not get the protection given to the small business in other industries . . . we need these protections. Bundling hurts the women-owned business.

In conclusion, given the importance of contracting, WCOE, we applaud Chairman Graves for introducing the Government Efficiency through Small Business Act of 2012. We also express our support and thanks to you, Chairman, for introducing H.R. 3893 on Subcontracting, and you, Ranking Member Chu, for your work on Mentor Protégé Programs. We also want to thank Congressman Hanna for his Bonding Bill and the other Committee members who have been, or are, in the process of introducing small business contracting legislation. Thank you.

Chairman MULVANEY. Thank you, Mr. McCallum.

STATEMENT OF MARK MCCALLUM

Mr. MCCALLUM. Chairman Mulvaney, Ranking Member Chu, members of the Subcommittee on Contracting and Workforce. Thank you for the opportunity to speak with you this morning.

NASBP members are companies employing licensed surety bond producers who assist businesses of all sizes to obtain surety credit and to grow as competitive businesses. Surety bonds assure that businesses seeking award of federal contracts are qualified to undertake the contract obligations sought and they provide guarantees of payment and performance if the business awarded the contract defaults on its contract obligation. Bonds are statutorily required and they preserve vital taxpayer funds and provide payment remedies to downstream parties, the subcontractors and the suppliers, in the event the prime contractor fails to pay them. Without recourse to a payment bond remedy, unpaid subcontractors and suppliers, particularly small construction firms, may not be able to continue as viable businesses, threatening the jobs that they create. Sureties underwrite to assure qualifications and to prevent losses. They assess the character, the capacity, and the capital of the firm, to determine if the business is capable of performing each contract.

An important SBA program exists to assist small businesses having difficulty qualifying in the standard market. Started in 1971,

the SBA Bond Guarantee Program provides guarantees ranging from 70 to 90 percent to surety companies as an inducement to extend surety credit, the firms that otherwise do not qualify in the standard surety market. This program has helped thousands of small construction firms over the years, but it could be helping even more.

The SBA recently has undertaken efforts to improve the program, such as streamlining its bond application process and improving its response time to claims and expanding its outreach to design build contracts. It is a good federal program that deserves to get better to continue to achieve its mission. Among the enhancements that we propose are increasing the guaranteed percentage to a uniform 95 percent, reducing the fees charged businesses and sureties to access the program, increasing the contract maximum from \$2 million to \$5 million, vesting discretion in the program administrator to assume program liabilities, and eliminating regulations out of keeping with prevailing practices of the construction and surety industries. Further recommendations are detailed in our written testimony.

Revitalizing this program with statutory and regulatory enhancements will increase its effectiveness, directly benefitting small businesses seeking access to the public contract market.

I now turn your attention to a bill, the Security in Bonding Act of 2011, H.R. 3534, which was introduced on December 1, by Representative Hanna and co-sponsored by Chairman Mulvaney. NASBP, along with 10 other national organizations, many of which are represented in this room, support H.R. 3534 as a critical and commonsense measure to protect small businesses and to ensure the integrity of surety bonds on federal construction projects when issued by individuals using a pledge of assets.

Currently, construction firms may use one of three methods to furnish security on a federal construction project. They may secure a bond written by a corporate surety listed in Treasury Circular 570. They may use their own assets to purchase and to post an eligible obligation, which is a public debt obligation of the U.S. government in lieu of a surety bond, or they may obtain a bond from an individual if the bond is secured by an acceptable asset which includes stocks, bonds, and real property.

The role of the surety is predicated on its financial standing. Corporate sureties writing on federal projects must possess a certificate of authority from the Department of the Treasury, which conducts a financial review of the surety and sets a single bond size limit for that surety. Corporate sureties are licensed in the states in which they conduct business and are required to obtain certificates of insurance in those states from state insurance departments. They are rated by private rating organizations, such as A. M. Best, which publicize their financial strength and size.

Individual sureties are not subject to the same level of scrutiny and oversight as corporate sureties and are vetted solely by contracting officers. No third-party rating information is available on individual sureties. If the assets backing an individual surety bond prove insufficient or nonexistent, unpaid subs and suppliers are denied their statutory payment remedy.

H.R. 3534 solves this problem. It requires individual sureties to pledge solely those assets defined as eligible obligations by the Secretary of the Treasury and provide those assets to the federal contracting authority, who in turn will deposit them in a federal depository, ensuring that pledged assets are sufficient, readily convertible to cash, and in the physical custody and control of the federal government. This is nothing more than what now is statutorily required of construction firms that wish to pledge assets as security on a federal contract in lieu of a surety bond.

Small firms working on federal construction projects, either as subs or suppliers, have no control over the prime contractor's choice of security provided to the federal government, but they suffer the most harm financially if that provided security proves illusory. H.R. 3534 will give them the confidence that on all federal projects adequate and reliable security is in place to guarantee that they will be paid.

Thank you very much for your time and attention this morning. I look forward to answering any questions you may have.

Chairman MULVANEY. Thank you, Mr. McCallum. Finally, Mr. Galarza.

STATEMENT OF MIGUEL GALARZA

Mr. GALARZA. Thank you, Chairman Mulvaney and Ranking Member Chu and other members of the Subcommittee for the opportunity to speak to you today.

My name is Miguel Galarza. I am from San Francisco, California. And I am the owner and founder of Yerba Buena Engineering and Construction. We have branch offices in Salt Lake City also. And in addition to all the accolades that Ranking Member Chu gave me, in addition to my family and daughter, some of the most proud things are being a state director for AGC and also a board of directors for ICA or the Inner City Advisors, which is a nonprofit providing assistance to smaller inner city companies.

As the founder of Yerba Buena Engineering, I have had a long road starting from in the field as a laborer to working my way up through a mid-management level and then becoming an owner of a company. And so I think I provide a unique perspective to what it means to be a small business from the eyes of an employee, from the eyes of a manager, and in the eyes of an owner. And having learned the ropes the hard way and understanding what it means to be a small business and understand the rules that are involved in playing in the game of surety and bonding and lines of credit.

So I am hoping that today through this discussion, obviously small business is a nonpartisan issue. Having this open discussion to be able to discuss how we can improve some of the subcontracting issues that are prevalent in federal contracting, the small business bonding issues that prevail and other bundling issues are prominent and how we can come to some resolution and some at least meaningful exchanges.

One of the things that being in eight states throughout the United States and having done well in excess of over \$100 million worth of work, we have had this unique perspective of having had Aerofunded projects. And these Aerofunded projects, Yerba Buena was the recipient of 21 of them. And we were able to create a lot

of projects and a lot of jobs to keep people busy and keep people employed. And that is one of the main reasons why I can see why bundling is important because when that funding came in place it was important that there was an avenue that silver-rated projects can be implemented quickly and efficiently and expediently to get people to work.

And so while there is a need for bundling in the form of an IDIQ or MATOC or as-needed contracts through IDIQ, there are other opportunities that are not being used now to create opportunities not only for those prime contractors but for those subcontractors that do not get that main prime contract. And that is where I see there is a big lack in opportunity.

Currently today, through FAR Subpart 19, there are requirements for subcontracting. Unfortunately, those numbers do not really become numbers. The reporting mechanism for subcontracting is done under, I believe, Note Form 244 or 294. That number or that form basically talks about percentages. It does not talk about dollars. So when you have a \$100 million contract, you do not talk about—you talk about 60 percent. Sixty percent of subcontracting. But what really makes up that 60 percent? It is the portion of which the prime contractor designates he is going to subcontract.

So in that \$100 million contract, if he decides he is only going to subcontract \$2 million and he says he met his goal of 60 percent, what is 60 percent of \$2 million? In the big scheme of things he can say he did 60 percent and he met his goal, but he really did not do much other than meet his minimum standard that was required contractually.

I think the City of San Francisco, the State of California, and other state agencies provide a true roadmap of how subcontracting should be done. It should be done based on dollars and on total contract value. That way you have an obligation to meet a certain requirement. If it is a \$100 million contract, we want 20 percent subcontract; that is \$20 million worth of opportunity. And developing a real statutory penalty for not enforcing and meeting those obligations that you set forth as we need the contract.

There is nothing worse than to win a contract and then say you are nonresponsive because you failed to meet your statutory requirement. That is the penalty that needs to be imposed. Only then when there are real teeth in enforcement will contractors begin to understand that that is the real price of doing business for the federal government. And they will start to reach out and look for opportunities for subcontractors.

There are other issues regarding bundling, subcontracting, but my time is short so let the Committee talk to me in questions if you feel free. Thank you again for the opportunity.

Chairman MULVANEY. Thank you, Mr. Galarza. And thank you to all the panelists. As is my custom, I will defer my questions to the end and ask Ms. Chu now to take her opportunity to ask the panelists questions.

Ms. CHU. Thank you. I will start with Mr. Galarza. You highlight the City of San Francisco and many of its practices, and one of those things that you highlight, certainly in your written testimony, is the Surety Bond Program that they have, which is a

model of their strong commitment to including the small business community in a major procurement program. How does this program differ from SBA's Surety Bond Program?

Mr. GALARZA. I think fundamentally the main difference is the mechanism, to be quite candid, reimbursement. Under the SBA funding you are still dealing with a broker who still needs to commit to a certain level of effort to get this contractor bondable and to make sure that he has all the steps in place, his financials and so forth. There is no guarantee that he is going to be successful and/or in other words earn a commission or increase some income for the level of effort that he has put into it.

So what ends up happening, unfortunately, is those thousand contractors that you mention utilizing are those that have been somewhat the low hanging fruit, the easy ones that have been cherry picked that are easy to access. They have financials. They have the tools in place already to be an easy target to be used.

The City of San Francisco does not use that methodology. They use the contract. The agency that is used to initiate the bonding program is paid a flat fee. And their job is to get the contractor ready to do business the right way. In other words, build their foundation so that at some point in time they no longer need the Surety Bond Program. They are in the game with the rest of contractors. Ultimately, this is supposed to be a developmental stage to get them to the next level. Not that they should depend on this 5, 6, 7, 8, 10 years down the road. They should be able to build their capacity, learn how it means to be in business, to report, to pay their taxes, to do what it needs to be part of the taxpaying community. And then you will be able to get bonding a lot easier. Those are all simple—bonding has not changed in 50 years. It is the same rules that have always applied. Ultimately, you choose as a contractor whether you want to play by the rules or not play by the rules. Unfortunately, so many small businesses do not understand what the rules are and so they are lacking that understanding so that they can play by the rules.

Ms. CHU. Well, for Mr. Galarza and also our expert on surety bonds, Mr. McCallum, should Congress consider scaling up or piloting this type of bonding program? If so, which agency would be the best to run this program?

Mr. MCCALLUM. I would think it would be through the Small Business Administration. I think there could be additional enhancements made. The industry itself has done a lot of outreach, particularly in the last three years, given the economic climate. And as Mr. Galarza points out, oftentimes one of the initial difficulties is that businesses just do not know where to go. They are not aware of what a surety bond is, how to go about it, and so forth. And so the industry has done a number of what they call contractor development programs which were programmed by the Surety and Fidelity Association of America and have been partnering with the USDOT, for example. They did 11 different programs last year. I think they are on track to do 11 or 12 this year, and it is designed to go out there into the small business community and give them initial awareness and education about bonding and other things, such as risk management, that they need to know in order to qualify not just for bonding credit but for financial credit as well.

And there needs to be more investment, I think, by any contracting agency of the federal government in trying to put on these types of awareness and education programs.

Mr. GALARZA. If I might add, in the 15 years that the city program has been in place, the millions of dollars of contracts that they have had, they have been able to collateralize these bonds with as little as 40 percent. And one of the key reasons that it works in San Francisco is because the city itself has put \$5 million in escrow. And that \$5 million means that the city has a vested interest in making sure the contractor is successful. After all, it is their money that is backing their own bond.

And so to make sure that we are all in together, so to say, rather than having an adversarial role, the city comes to the table and says how can we make sure you as a contractor are successful? What is it that is going on in this project that is preventing you and the project itself from meeting success. So given that it is their money they have a vested interest in making sure that it succeeds.

Mr. MCCALLUM. If I may add an additional point, one of the things that our members seem to find out that a lot of times with an emerging business there is a reticent to take their hard-earned capital and apply it for the services of a construction attorney or a construction accountant. That can be a significant fee for them when they are just getting started. At the same time that is exactly what they need to be doing to make sure that they are building their business infrastructure so they can succeed and go to the next level. And there are sometimes local programs that will, through a grant of funds, help them with securing those kinds of professional services. Or alternatively there may be opportunities through, for example, the SCORE program where you have retirees who are construction lawyers or accountants come and provide those kinds of services for businesses.

Ms. CHU. Thank you. Those are great suggestions.

Now I would like to direct a question to Ms. Privitera Biondo. I was very interested in your recommendations because, of course, in federal government we have this 5 percent goal for women-owned businesses but we are only at 4.04 percent, which is a huge amount if you think about the fact that we have over \$500 billion worth of federal contracts. So we really need to improve this situation. And in your testimony you bring up the practice of prime contractors bid shopping subcontractors and they will submit their proposal with the women-owned business or other small firms. But once they get the contract then they make this last minute substitution with a business that offers a lower bid and then they will pocket the difference. It is a terrible practice and has a negative effect on women-owned small businesses. How could we stop prime contractors from this "bait and switch"? I know you talked about requiring a listing of subcontractors but if you could expand upon that.

Ms. BIONDO. Sure. In Kansas City, at the city level, they have implemented a program so when you even bid on a traffic signal project and if they ask for small business, minority participation, other venues inside that, you actually list that information at the time of bid. And then it goes back to a Human Relations Department. So in this case it would be a contracting officer. They review

that information. At the time of bid those subcontractors actually sign an affidavit saying this is my number, this is how much my bid is; I am good for it. And so when it is submitted to the city, the city sees these are the major subcontractors listed so that way they know unless something happens after the fact, at least the city can vet out what happened. If the company needs to remove themselves from the project or whatever that may be, but we have found that that has eliminated a lot of the after-the-fact shopping.

Ms. CHU. Now I would like to ask about the bond limit, the maximum bond limit. The American Recovery and Reinvestment Act temporarily increased the maximum bond limit from \$2 million to \$5 million. And bonds of up to \$10 million could be authorized if a contracting officer certified that a bond over \$5 million was necessary. Unfortunately, this provision has expired and I know, Mr. McCallum, you talked about how increasing it would certainly help small businesses compete for bigger contracts. Should Congress permanently extend the bond limit? And what maximum bond limit should be available? Anybody on this panel.

Ms. BIONDO. The women believe that it should be extended at the R rate that was in existence prior to this. It has expired. So at a minimum where it was before.

Mr. MCCALLUM. You know, as you recounted, it was \$5 million increase during the economic stimulus and then up to \$10 million should a contracting officer certify that there were appropriate circumstances. We think a \$5 million limit would be a good limit. I think it is recognizing that even for smaller procurements they are getting larger. And it would give the small businesses who are participating in that program the opportunity to seek more federal work. But you have to remember the program itself is helpful in other contexts, not just federal work but other public work contexts as well where they may need that credit line.

Ms. CHU. My final question is for Mr. Galarza and Ms. Privitera Biondo. Agencies are required to review contracts and bundle requirements of two or more goods or services where it is previously provided or performed under separate contracts. However, since construction contracts are new requirements there are those that argue that these contracts do not need to undergo the same bundling scrutiny. Courts have yet to rule definitively on this issue but I think we should focus our attention on contracts that are more likely to be bundled. What types of contracts do you see bundled that could clearly be broken up and bid on by small businesses?

Mr. GALARZA. Obviously there are reasons for bundling, either capacity, the nature of the work. For example, in our home state of California there are often large environmental contracts that require extreme expertise that are not available to small business. And so I can see that. The reason for having a bundled contract, those are typically \$500 million to a billion dollar programs involving environmental clean-up in BRAC facilities. However, on the other side, the opportunity to create a smaller, say baby RAC (Remediation Action Contract) so that you, although you have a bundled contract for the large prime contractors, you enable smaller prime contractors to gain traction and to learn how to do that similar work and so that they can build their capacity at that same level.

Ultimately, these large businesses were small at one time and they obviously built their bonding capacity to get to that level. And obviously, that would be an excellent opportunity. Agencies, like the Corps of Engineers, the Navy, they have BOAs, they have MATOCs, they have smaller procurements that give expertise to smaller contractors. All I would say is it is create an opportunity. If the contract needs to be bundled, create an opportunity where there is a similar myriad opportunity for small business so that they can indeed do the same thing.

Ms. BIONDO. And I would say that I believe that the women have an opportunity to get more prime contracts. If you have a \$5 million contract I guarantee you they can easily take \$20 million out of that and scope it out so a woman or a minority can go and be a prime contractor and achieve that. The problem is once you bundle it they do not reach down that far to you. But those large projects, they can break scopes down. The larger the project, the easier to break the scope down. The smaller the project, the harder to break the scope down because there is so much more to work with. So I just think it is a choice and I think they need to break them down further.

Ms. CHU. Thank you. And I yield back.

Chairman MULVANEY. Thank you, Ranking Member. I turn now to the gentleman from Florida, Mr. West.

Mr. WEST. Thank you, Mr. Chairman and Ranking Member. And thanks for the panel for being here.

I just have one basic question. I think it is great today that we have the private sector representatives here and then also we have public sector representatives here. We have folks that are here from the SBA, from the Office of Surety Guarantees. We have the chief of Engineering Construction from the Corps of Engineers. And we also have from the GSA their representative as far as construction. So what I would ask is this. What would be the one or two recommendations, concerns that you would like to say to them from the SBA, from the GSA, and from the Corps of Engineers as far as policies, regulations, processes, best practices, procedures since we have all of these players in the same room at the same time?

Mr. GALARZA. If I may, thank you.

As we all know, construction is about building a good foundation. And that foundation starts with training and starts with a teaching program. And as we move forward, the issues involving defunding organizations like Department of Commerce and NBDA, either succumbing them into other organizations, let us not make sure that those training opportunities do not disappear. And that SBA and their budget does not get shrunken any further. They are in a tenuous position trying to do too many things with too far few people. And without, as we all know the old proverb, I can give you all the fish you want but until I teach you how to fish you will not sustain yourself. And ultimately, the responsibility is to give an opportunity to a contractor, not give him a contract, not give him the opportunity but teach him how he could sustain himself and then continue to grow to the next level once he moves out of an 8A program, out of a HubZone program. So he can bring opportunities to his own community. Without that training and without that effort then they will always be looking for the opportunities that are

given to them rather than those that they can reach out for themselves.

Ms. BIONDO. I would like to go back to the size standard issue. This has been an antiquated program in place for many years that there has been a lot of discussion on. And you know, to ask for something as simple as move from a number of employees to revenue and to not get much movement is very difficult. But if we could have some consideration in that area because it is done so many different ways it is not consistent.

Mr. HAIRE. From AGC's view, we would like to see some clear rules, safe harbors, if you will, on how SBA evaluates the affiliation rule, particularly with respect to subcontracting between small business prime contractors and large business subcontractors. There is a lot of confusion in the marketplace. There is a huge amount of bid protest activity going on right now. And we would like to see some clarity. We think if SBA could clarify for everyone what small and large businesses can do in a subcontract relationship it would benefit the industry and the agency's and the SBA's programs and goals.

Mr. MCCALLUM. And I would add in terms of training just internally, that they make a commitment to train their procurement officers. There is a lot of concern in the private sector that there are a lot of retirements that will happen for very skilled procurement officers. They have a tough job. They do a wonderful job out there. But as new folks come in they need to have the training to carry on with their complex tasks that they have. So I would urge them to do that. And from my own perspective, as well, an adherence to the Miller Act requirements. We sometimes see that they are not adhered to. They are there for very good public policy reasons and that needs to happen.

Mr. WEST. Last quick thing each one of you. If there was one onerous federal regulation that you would want to see repealed what would it be?

Mr. HAIRE. I will take that one. AGC for several years has asked to have a line from FAR 52.219-9L removed. It is FAR clause 52.219-9L as in Larry. There is a sentence in that particular FAR clause that places a restriction against counting lower tier subcontracting in the small business subcontracting goals. Obviously, Congress could choose on its own to take care of that issue but also the FAR Council if it so chose could simply go in and delete that reference.

And I would also point out the government's Electronic Subcontractor Reporting System now has the capability to easily allow tracking at all levels. It is not the paperwork complication it was before it was all computerized. So AGC would like to see that.

Ms. BIONDO. There is—I am trying to think how to say this—there is a bid process in place where you submit your bid on-line and then they come back and they ask you to counter your bid and counter your bid and counter bid. It is sort of, in my mind, similar to this bid shopping. So I am concerned how that works because basically you are giving your price and you are asked to continually think about lowering your price. And you are bidding against a blind computer that you do not know why you are doing it. What

is the logic behind it? If you are taking out scope. So I would like to see that changed.

Mr. MCCALLUM. Since you have rattled my memory on that, and I think you are referring to a reverse action process, we feel that it is very problematic anytime you commoditize construction, because construction is unique in every instance. You have unique site requirements. You have unique owner requirements, and all the rest. And so a process or a procurement process that does not recognize that is I think very problematic. And particularly so for a small business who cannot finance the risk. So if you commoditize it, you are cutting the margin. You are putting difficulty on letting them compete, and that should not happen.

Mr. GALARZA. In regards to legislation, but more of a practice, the Committee has talked about bid shopping. And unfortunately we had the example of the government bid shopping in the form of BAFOs (Best and Final Offers). I have been involved in rounds of BAFOs for the same contract five and six times over and over and over again. It seems that some agencies are not quite happy with what the competition has felt is a fair and reasonable price and they want a lower price. And they continue to ask for a lower price. And so if there was going to be a meaningful change, maybe a reason for one BAFO, but multiple BAFOs on the same solicitation seems unfair and unrealistic and unreasonable.

Mr. WEST. Thank you very much. Thank you, Mr. Chairman. I yield back.

Chairman MULVANEY. Thank you, Mr. West.

I turn now to the gentleman from New York, Mr. Hanna, the primary sponsor of a bill that I am associated with. So Mr. Hanna.

Mr. HANNA. Boy. It sounds like nobody here likes to compete. Let me just play devil's advocate for a moment.

What is wrong? I mean, if you do not want to sit at your computer and have a reverse action all you have to do is shut the darn thing off and not bid it. Those are your options. Or stop—put your price out there and leave it there.

I do not—I have never—I mean, I have never been offended by anybody who sought the best price for anything. It is a brutal world out there. We know that. And I do not know that the government should necessarily be in the business of taking that marketplace away, but I absolutely sympathize with that because I understand what you mean.

The other thing I would like to say is that in terms of having an auction or you putting a price in on bid day and somebody changes it later, Ms. Biondo, you may have answered this but what do you think is wrong with that?

Ms. BIONDO. To change the bid later?

Mr. HANNA. No, for somebody to come back to you and say—or not come back to you a week later and say, you know what? We had someone call and their price was lower. Or let us say, for example, they say to you, you know what? Your price was the lowest price but we want to pay more because we know someone who we feel is more qualified. I mean, that also could happen.

Ms. BIONDO. Okay. Well, I will try to be pretty clear here. First, when you said I could stop bidding. Well, you already took three bids or more so you already had multiple choices of multiple num-

bers from right out of the box. You always have a minimum of three bids if I recall. So you had three multiple choices so you had three different people who bid. I think that should be enough.

Mr. HANNA. I do not, well, I am not here to argue against you.

Ms. BIONDO. Okay. So then—

Mr. HANNA. Let me just say this though. First of all, why is it enough? Why is one not enough?

Ms. BIONDO. So now I am going to go to your next thing that you said about—I do not know how you said it, but why do I think that is not fair? I think that is what you said.

Mr. HANNA. Yes, ma'am.

Ms. BIONDO. This is government money. So this is our money. It is not private money. If it is private money and the owner chooses to go with a lower bid, I can understand that. But this is the government's money so every person in this room has the ability to go after that. And I do not think that the process that they have makes that fair.

Mr. HANNA. Should not the government be in a position to get the best price it can? Is that not the ultimate responsibility for the government to find the same goods or service or both at the lowest possible price?

Ms. BIONDO. Yes. And that is why you go for multiple bids. You had multiple choices. But when people put those numbers together and companies spend thousands of dollars putting bids together and are unsuccessful in that way, I mean, there is a lot—it is not like you just put your number out there and it did not cost your company any money to put the job together. I mean, how about when your company spends \$100,000 putting the bid together and you did not get it?

Mr. HANNA. That is life. Some other company did. And somebody got a better deal. And I assume that the ultimate goal of all your companies is to be competitive. Or no matter what we do from this seat or in this House, we cannot control how competitive you are. Only you can. And the work is getting done and somebody is doing it. And that person presumably is the most qualified at the lowest price.

So I appreciate that you like not to have to compete as much. I appreciate that you like not to have a prime contractor to be able to go to someone after the fact and shop your price which I would agree with anybody here there is something unethical about that. I do not disagree. But it does not make it illegal, and certainly it may be the case that somebody actually found a great deal better price. And we have to remember this is the beginning of the job and a prime contractor, if it is a big job that is bundled, there is no guarantee that the profit he took by getting a lower contractor will actually help him finish that job. He may need that money to be successful.

Ms. BIONDO. Well, let me say that speaking on behalf of my own personal company, we bid thousands of jobs every year and we compete on a day in, day out basis. So for you to insinuate that I do not like to compete, I take offense to that because we compete constantly and we understand what competition means. And I welcome it.

Mr. HANNA. You must be doing well. I mean, obviously you are competitive or you would not be here. So I give you credit. It was not meant to offend you. It is a simple question. I have lived in your world for 30 years and dealt with the same circumstances.

Mr. Galarza.

Mr. GALARZA. Yes, sir.

Mr. HANNA. If I may? I am out of time.

Chairman MULVANEY. No objection.

Mr. HANNA. Thank you. Thank you very much, Mr. Chairman. What do you build?

Mr. GALARZA. We are a heavy civil contractor. Roads, bridges, pipelines, things of that nature.

Mr. HANNA. And so I have to ask you. If you can do all of that, and this is meant in the kindest way because I understand the nature of accounting and bonding. Everything you go through is awful. But if you can do all that and you are an engineer, why can you not figure out your own bonding needs?

Mr. GALARZA. I certainly can. This issue is not about me. This is about the tens of thousands of contractors that do not know what to do. Just because you are a contractor does not make you a builder. It just means you passed the test. And just because you are in business does not make you a business owner. It just means that you signed up for a business license. And so unfortunately, when you get into environments like a reverse auction you have that contractor who has no clue what that means. So he gets sucked into the competition just like playing poker. And unfortunately, he has found the quickest way down to bankruptcy and not understanding what he has gotten himself into. And yes, I got the job but I cannot pay my bills. I cannot pay my vendors. I cannot pay my taxes. I cannot pay my FICA, my FUTA, my SUI. But I got the job. And unfortunately, that is what happens when you open up a competition where you have people that are not knowledgeable enough to understand the ramifications.

Mr. HANNA. But is that not exactly the point, that the bonding is that firewall between those people and more qualified people? And by removing some portion of that firewall that has existed for so many years, 50 years, and I would argue bonding has changed in the last 10, 20 years to its detriment because it does let marginal people in. Not that I am not supportive of minority bidding, et cetera, but do you see in your mind a point at which there is too much of that where severely marginal people get into a business that frankly they are not qualified for? That there is so much assistance it actually encourages their own demise? There has to be some kind of bottom-line limit where a person has to have more than a pickup truck and a hammer.

Mr. GALARZA. No question. And I would agree with you. I think the point that you have made earlier about competitiveness is tailored to the large business. He gets a preferential bonding credit. He gets a preferential line of credit. So his cost of money is cheaper than the small business. His cost of bonding is cheaper than a small business. His tax rates may be sweeter. He has a better tax accountant. All those things play in favor of the large business who is able to bring his bottom-line so that he can be competitive at 2 percent. Whereas, the companies that are trying to get to that next

level have a higher cost of money. Have a higher cost of bonding. Have a not so good CPA. Not so good banking alliance. And so their cost of doing business, while they have made as little profit as the other company, it cost them——

Mr. HANNA. You know, let me just agree with you 100 percent. The process is this. That a guy starts small. A woman starts small. They learn. They build up resources. They build up knowledge, skill. Employees with the same. They get a better lawyer. They get a better accountant. They start to make a few bucks. They get cash reserves. They get a bigger bond. They do it all over again the next year and they get a bigger bond and a bigger bond. And ultimately, you can do exactly what anyone else can do and that is to grow a large \$10, \$20, \$50 million business and bid work appropriately. But personally I like the fact that you learn as you go and you require and attain bonding and credit as your binding and credit capacity grows based on your knowledge, your skill, your income, and your financial statement.

That is why bonding has worked so many years. And the problem with bonding today is that it is supposed to be a zero loss ratio. Is that correct, Mr. McCallum?

Mr. MCCALLUM. Yes. That it is written under a theory that there will not be loss.

Mr. HANNA. Right. So it is not a zero loss ratio anymore. And because marginal people get in it adds difficulty. I am way over my time so I will end there but thank you for your tolerance.

Chairman MULVANEY. No, that is fine, Mr. Hanna. I am glad you had a chance—I want to begin my questioning on something you raised which I think bears further discussion because no one here I think is against competition. You make an excellent point. But I would think having been through this process myself, both as an owner and as a bidder, one of the difficulties that I always faced was knowing what the rules were in advance. That if I was going to bid on anything, whether it be a contract, a piece of land, a building, I wanted to know if I was in a reverse action, I wanted to know how many rounds of bidding there would be. I would want to know if there would be multiple best and last offers because if I ended up with the rules changing as I got into the process, over the long term it has a chilling effect. And the next time a bid comes up from that particular or that same organization or a similar organization, I might be much less likely to bid. And I think in the long run, if we allow that environment to prevail when it comes to government contracting, what you will see is folks like Ms. Biondo or other organizations simply drop out of the process and decide if I do not know what the rules are in advance, if I am going to waste all my time and my money to go through these multiple rounds of bidding, then I am not going to do it. And I think in the long term that may have a detrimental effect on the price the taxpayer ultimately pays.

Everybody up here, and you and I know each other very well, are interested in seeing the best deal for the taxpayer. But I also think there is a long-term consideration over the system that we create as opposed to looking at everything as a one off kind of deal.

I will start with my questions and then maybe we can come back and throw it up under further discussion. I want to start with—

we will just go in order, Mr. Haire. You had mentioned that there were no rules on subcontracting by small business to large businesses. There are no safe harbors. It was done on a case-by-case basis. As someone who used to practice law I can tell you that the world of case-by-case basis is the world in which the lawyers thrive. We love that kind of thing because it simply drives litigation.

Give me some suggestions. When we talk about that world of small businesses subcontracting to larger businesses, which we know not only happens but has to happen in certain circumstances. Give us some suggestions for safe harbor rules that you would like to see.

Mr. HAIRE. The two biggest challenges, and you probably are all aware, but how this typically comes up is through the bid protest process. So a competitor will protest a bid of another contractor who is the apparent awardee on the basis that the business relationship between a small prime contractor and one of its subcontractors who happens to be a large business is in violation of SBA's affiliation rules. So a lot of the reason why there is a basis for the protest is because of allegations related to the bonding relationships that are utilized in the project. The prime contractor is required on nearly every federal project—I think Mark would say every federal project to his Miller Act point—about making sure that you post a bond. And oftentimes the size of the small business set-aside project is so large that the subcontractor may be looked for to provide some assistance in the form of maybe an indemnification or things like that to help the small business subcontractor provide the bond.

AGC's view and our view, my view is, you know, that is not something that in and of itself should be improper. You have to look at other things. And I think you could develop a set of rules where, you know, that is something that is specifically remitted. For example, in the Mentor Protégé Program, allowing the mentor to help support the bonding program of the protégé is specifically allowed and often included. And I think it helps build, you know, a level of relationship for the small business that it can develop with its surety that in some cases is very helpful. But that is a very heavily litigated area right now in this type of work.

Another example of a safe harbor that I think would be useful is some kind of, you know, clear rule on whether or not different parties can utilize employees of different companies. Just some clarity. You know, so that everybody is playing by the same set of rules because different competitors will choose to do different things related to how they get labor and executives onto a contractor's staff. And if one contractor is, you know, because of the absence of rules is doing something and another contractor is not, that often can make the difference as to who gets the job based on competitiveness and a whole range of factors.

And I guess my last point, the reason why this has become such an issue is because the Small Business Act has a provision in it that says if you misuse the goals of the Small Business Program you potentially are subject to False Claims Act liability. And there is no clear guidance on what is and is not an improper practice relative to the small business rules. And we are starting to see both

offices of inspector generals and in some cases U.S. attorneys who are taking a look at what we think are legitimate business practices and taking a different view of that and saying that is improper. And now all of a sudden you have got, you know, investigations ongoing with a lack of clarity as to what is permitted.

Chairman MULVANEY. And by the way, to the next panelists, Mr. West hit on this, a lot of times what we would rather see is a back and forth between folks in the private sector and the folks in the SBA and the GSA. So to the extent the next panel is in place, I encourage you to listen as we go through all of these questions but specifically these because what we would like you to do is respond specifically to things such as the recommendations, the request that Mr. Haire just made.

Let us talk about bundling for a second because I was surprised when you get down to the weeds of bundling, one of the—it is not a loophole but it is a gray area in the law that essentially removes or could be determined to remove new construction from the prohibition zone bundling. Tell us a little bit why that is and how you think we can fix that.

Mr. HAIRE. Well, I am not exactly sure why that is.

Chairman MULVANEY. No, the definitional issues.

Mr. HAIRE. Well, AGC, and I am not even sure I am going to be able to answer your question the way you want it for lack of understanding on my part. But I think AGC's view is that there are a variety of contracting vehicles that are used by the federal government and several of the panelists here have touched on the bundling issue. We think that bundling in general, as long as you—I think what I heard Mr. Galarza say is that perhaps you could take a series of smaller projects which could be placed in an IDIQ or a multiple award vehicle, and as long as you, you know, set those aside for small businesses, even though that is technically bundling it, it would not hurt small businesses is perhaps the way to say it.

And the flipside of that is, you know, what AGC looks at are these larger, multiple award contract vehicles where maybe you are taking, you know, \$500 million down in New Orleans and you are sticking it into a multiple award vehicle. And only large businesses are going to qualify for that even though you may have 50 projects that could come out of that and a per project average size of, you know, \$5 to \$10 million. And I think the concern is if you are taking that type of bundling and sticking it into a vehicle it does hurt small businesses.

Chairman MULVANEY. Bundling is a many splintered thing it seems sometimes. One of the issues that we came across in one of our field hearings was that new construction, there is a prohibition on bundling in many circumstances. But because of the way the language is written, new construction is often excluded from that prohibition so that you are allowed to bundle contracts on new construction that oftentimes effectively remove small businesses from allowing to bid.

Which leads me to my next question because one of the things we heard, both in California and in South Carolina when Ms. Chu and I conducted our field hearings, was frustration over the amount of contract work that stayed local. The example I remem-

ber from my district, was \$103 million project of which less than \$200,000 actually went to local businesses. Now, you mentioned during your testimony that generally you are concerned about a local preference, that you think it might have a negative impact. Tell me why that is and tell me your thoughts generally on local preferences.

Mr. HAIRE. The concern with local preferences and many other preferences often is the reduction in competition and the price pressures that naturally occur as a result of that. I mean, taking the flipside, I was in Puerto Rico at an agency meeting last month and the Puerto Rico AGC constantly is concerned about the fact that the larger mainland United States contractors come down there and compete in Puerto Rico for GSA projects, Corps of Engineers projects, things like that. You know, it is a—sometimes a challenging set of circumstances to balance, you know, cost with the desire to provide more opportunity for local businesses. And I think sometimes there is a tension there.

Chairman MULVANEY. There is tension. Certainly, again, as Mr. Hanna said and I think as everybody on this panel agrees, we are interested in getting the best deal for the taxpayers in both the short run and the long run to the extent that is possible. But I cannot remember if it was your testimony or Mr. McCallum's, that one of the things we struggle with in the construction business generally is the attempts to commoditize the product, recognizing that it is not a commodity product. The construction in California is different from construction in South Carolina. And that sometimes, maybe under limited circumstances that could still protect the taxpayer, I do want to continue to explore the possibility of looking at local preferences. But we will deal with that as it comes.

Mr. McCallum, you talked about the size standard, which, listen, we ran a small business that had very high revenues with very few number of people because we were able to subcontract out of a lot of our business. If you build houses you could do that. Plus, if you are selling something that sells for a relatively large amount of money, regardless of the size of the profit margins, and if you measure by revenue you might be large; if you measure by number of employees you might be small.

So while I share your concern, and I sympathize with you to a certain extent, tell me how to deal with the other circumstance where I might be a business that sells something that does not cost very much but employs a large number of people. And that is why we run into this because we want to treat them as a small business as well. So help us walk that fine line between counting something that is a small business, is a large business, and vice versa.

Ms. BIONDO. Well, in construction, what we find is a great number—a great deal of our money is spent on material. Subcontractors, equipment. So if you actually look at the size of a company, is it valued by their gross revenues, their net income? How are you really looking at that? There is not a clear definition as why they are looking at the top revenue.

So if you were to look at what I actually expend in labor, that might be a better indicator. If you were allowed to maybe exclude out your material and subcontractors, because this is work that was actually performed by your own forces. So it would perform a

commercial useful function in the construction industry. That would make sense to me. But to just say that because you do \$7 million a year you are a big business, I do not understand that. I do not think it makes sense when other companies can do \$100 million and still be considered small because they had an employee count of less than 1,500 people. So how can someone who has 1,500 people still be considered small but—I am just going to use my own company's example—if I do more than \$14 million, I am not considered small. And I have less than 500 people. I cannot understand that.

Chairman MULVANEY. We struggle with it as well. As somebody who used to be in the private sector and then ended up on this Committee, I was stunned to find out that not only do we do that but we change the definition from industry to industry. So while we are here today talking about general construction industry, there is a different measure for what is small within pharmaceuticals versus construction versus transportation. So we sympathize with you and I can assure you we are trying to figure out a way to bring some reason to that system as well.

Talk to me about retainage. Again, a circumstance where I am sympathetic to the plight that you brought to us today because I have been on your side of contracts. I have also been on the other side of the contracts and I found retainage to be a really, really good way to make sure the job gets finished. And while your claim is correct that I, as the owner or as the prime contractor, I could always turn to the bond. I could assure it was much easier to make sure you finish the job by keeping at least a little bit of retainer. So how do we balance that?

Ms. BIONDO. Well, as you know, it will be difficult to give you all the different scenarios in our testimony because there was a lot of controversy in regard to the retainage. But the retainage we understand when you are a general—

Chairman MULVANEY. By the way, am I using—because we call it retainage. It is called retention. Are we talking about the same thing?

Ms. BIONDO. Yes.

Chairman MULVANEY. Good. Thank you very much.

Ms. BIONDO. Yes. You know, in a lot of instances when you work in the private sector, if you are performing a large contract and you go back to your general contractor and say, hey, you know, I am just about done with this job. Can you reduce my retention by 5 percent or at the 50 percent mark, you know, is it necessary for you to continue to hold 10 percent? Most of the time in the private sector our own will come back and say, "Hey, yes. You are doing a great job. I will reduce your retention." If you are not doing a good job, obviously they are going to hold your retention. So the problem is how do you do this with the federal government so it is clear? And the way the rules currently read, it says they do not have to charge that.

Well, look at it from another perspective. Business is not all that great for most contractors these days. At the end of the day on their financial statement, maybe they might make 1 percent. Okay? If you are holding 10 percent of that project until six, seven months after a job is completed, you have officially become that

company's bank for them because they have had to go and borrow the money before they get that last 10 percent of their job.

Chairman MULVANEY. Yeah, but when I dealt with retention it was simply until the work was completed on the contract, not the overall job was completed.

Ms. BIONDO. Well—

Chairman MULVANEY. That circumstance I could see it would be a problem but how could—if I am the owner and you are the contractor, how could you object to me withholding 10 percent until the final piece of work on your contract is finished?

Ms. BIONDO. Okay. So say you finished your job in September and the entire project was finished in September, all scopes.

Chairman MULVANEY. Okay.

Ms. BIONDO. And you do not get paid for a whole year because the owner does not choose to pay you for a whole year.

Chairman MULVANEY. Okay. Maybe we are talking about something else. To me that would be a breach of the contract. But I see what you are saying.

Ms. BIONDO. But again—

Chairman MULVANEY. Let me ask you one more question and then we will move on, which is bid shopping, because it is something I struggle with as well. I do not care for it. My state has banned—several states have banned. What is the experience within the industry? Have the states banned? I think it is 10 or 12 states that have done it. Has that proved successful? Have we managed to solve this problem in the states that have banned bid shopping?

Ms. BIONDO. I do not know the answer to that. I am sorry.

Chairman MULVANEY. And neither do I. Very quickly, I have—early on in the process Mr. McCallum, or earlier on this year I became aware of some of the issues that deal with surety bonds through something that happened back in my district. An spent a little bit of time getting up to speed on the issue, only to find that Mr. Hanna had already done a considerable amount of work on it. So I would like at this point to yield four minutes to Mr. Hanna to ask questions of Mr. McCallum specifically on H.R. 3534.

Mr. HANNA. Is there anything you want to say about it?

Mr. MCCALLUM. We touched on it I think earlier in my testimony. Right now, particularly in the difficult environment, it is very difficult for construction firms. They have been very much impacted in this environment. And so sometimes their balance sheets are not what they used to be. And there are times, whether they are tempted to seek a market that they should not seek, or what have you, they can be preyed upon by individuals who are not licensed at the state level. They are not vetted by the Department of Treasury. They just exist and will sometimes proffer their assets to act as an individual surety.

It is a caveat emptor situation. And I think small businesses cannot and should not be victimized. There is a simple solution, and the solution is just make sure that the assets are real; that they are convertible into cash so if a claim happens, that it can be readily rectified. And that it is in the care and custody of the federal contracting agency and the federal government.

Currently, under the FAR, which I believe is fundamentally flawed, the contracting officer shoulders the entire burden. They

are very busy folks who have a lot thrown at them. This is a burden that they should not necessarily have to bear or at least it should be lightened.

Individual surety. The program has actually been problematic over a number of decades and they tried to fix it—in the fall of 1989 and in 1990. But we are still having problems currently in that regard. And there is plenty of documented cases about that.

Again, H.R. 3534 is a simple solution that would basically make sure that parties, if they are subcontractors or suppliers that they have a valid payment bond in the event they are unpaid.

And on top of that, individual sureties, if they use eligible obligations, meaning a public debt obligation of the U.S. government, could actually use the interest off that once the obligation is completed.

Mr. HANNA. I hated retentions but I always, I mean, whatever the contract was when I started the job. I never assumed that it would change after I finished the job. So it was about 10 percent. You would always ask for less but you never got it and moved on.

The fundamental problem is that it is the one thing that protects all of us against bad actors. And when you let someone in that business in the bonding business, as an insurance company you are actually saying we accept you over them. And if they are no good, you have got nothing. And the problem with bonding is it is the one of the few areas of law where we rely almost completely on history on the bonding companies' desire not to lose money. Hence, the zero laws ratio.

What has happened is people have gotten in the business and they forced other insurance companies to raise the cost of bonding, even though there is implicit there will be no losses because there actually are losses. The goal is not to limit people's access to bonding; it is to try to keep it so that good actors are in that business. And what ultimately does is it lets good people who are good intentioned and talented go to work. And it secures those people who have been in this business for years who if you earn your way up to the ladder, who have that million dollars in the bank to do a \$20 million job, who have those three or four hundred employees that know exactly what you are going to do the say they get there. And when you do not project bonding, you are not protecting the contractor, you are not protecting the government or the taxpayer? And most of all—you are hurting the individual's ability, who is a good contractor, to stay in that business. And that is why I am, you know, involved in this.

Chairman MULVANEY. Thank you, Mr. Hanna. Folks, thank you very much. I appreciate your patience and thank you for your testimony today.

If we could have the second panel, please, step up. That would be great.

[Recess.]

Chairman MULVANEY. All right. We will go ahead and get started with the second panel.

STATEMENTS OF JAMES C. DALTON, P.E., CHIEF, ENGINEERING AND CONSTRUCTION, U.S. ARMY CORPS OF ENGINEERS; JEANNE HULIT, ACTING ASSOCIATE ADMINISTRATOR FOR CAPITAL ACCESS, SMALL BUSINESS ADMINISTRATION, OFFICE OF SURETY GUARANTEES; WILLIAM GUERIN, ASSISTANT COMMISSIONER OF THE OFFICE OF CONSTRUCTION PROGRAMS, GENERAL SERVICE ADMINISTRATION

Chairman MULVANEY. The first witness here is Mr. Dalton. He currently serves as the chief, Engineering and Construction, for the U.S. Army Corps of Engineers. He is responsible for the execution of \$10 billion of design and construction programs for the Army, Air Force, Department of Defense, and other federal agencies, and over 64 nations. Welcome, Mr. Dalton. Thank you for your service, sir.

Sitting next to him is Mr. William Guerin, the assistant commissioner of the Office of Construction Programs at the GSA's Public Buildings Service. Mr. Guerin is responsible for the construction of the GSA's more than \$1 billion per year of capital construction programs, including the design and construction of federal buildings, land, ports of entry, courthouses, and other projects for the nation's landlord. He is also the recovery program manager and recovery executive, overseeing the timely delivery of high performance green building projects worth more than \$5.5 billion, which I think together we have about \$20 billion worth of management on this panel. So thank you gentlemen for being here.

And the final witness is Mrs. Jeanne Hulit, the acting associate administrator for the Capital Access Office of Surety Guarantees at the SBA. She manages and oversees the SBA loan programs and is here today to talk about the Bond Surety Program and specifically H.R. 3534.

So with that we will begin because it says so on the paper with Mr. Dalton, even though he is sitting in the middle. Mr. Dalton, fire away.

STATEMENT OF JAMES C. DALTON

Mr. DALTON. Thank you, Mr. Chairman and Ranking Member Chu. I really appreciate the opportunity to be here today to testify before this Committee. I especially appreciate the opportunity to listen to the previous panel. It is always interesting to hear what our industry partners think and offer as suggestions.

Certainly, small businesses are a great value to this nation and we in the Corps will continue to do all we can to promote those small businesses and to help them to grow. During the FY11, the Corps exceeded its small business goal of 35 percent and we actually awarded 42 percent of our contracts to small businesses. This really equates to about \$8 billion to small businesses, and of those \$8 billion, 3.3 billion of that was to small businesses as prime contractors.

In addition to that, the Corps prime contractors awarded a high degree of their subcontracts to small businesses. About 63 percent of the subcontracts went to small business subcontractors. But having said that, the Corps continues to look for ways to improve its relationship, as well as help to grow those small businesses into large businesses.

Today I would like to just talk about a couple of those, what I would classify as sort of internal hindrances or obstacles for small businesses. One would be that in a lot of cases, certainly not all cases, small businesses may lose out on opportunities to actually influence the acquisition process, because they do not respond to sources sought in synopsis. If we get two or more small business contractors then we will set aside that acquisition for small businesses. We certainly would encourage small businesses to pay attention to that.

The second is, in some cases, we have companies that will focus more on the small business certification or the 8A certification when they submit proposals rather than focus more on the qualities they bring to the project. Their past performance, their current experience, et cetera. These are the kind of things that we talk to small businesses about to try and encourage them to put together better proposals.

But, in addition, there is the bundling aspect of it that you talked about. The Corps of Engineers does not bundle contracts, but I think what you are referring to is the consolidation of contracts. We do consolidate contracts, but the rules we follow are very close to the rules one would follow if, in fact, you were bundling contracts. I'll probably get a chance later to discuss that a little bit more.

We require performance and payment bonds or surety bonds, for acquisitions over \$150,000. We have discussions with our small business community but we are sensitive to this and we try and adjust our acquisition sizes to ensure that we do not do something that detracts or takes away from small business opportunities.

The last thing I will mention here is that with regard to prompt payments, we actually have paid 98.5 percent of our contracts in timely payments. We pay prime contractors within 14 days. Construction contracts as required. And for subcontractors, a certificate is required from prime contractors to say they have paid their subcontractors before they submit a request for payment to us.

I would like just to close and say thanks again, Mr. Chairman, and the Committee, for allowing us an opportunity to come here and try to help you address the problems that you have discussed.

Chairman MULVANEY. Thank you, Mr. Dalton. We will come back and ask questions in a second.

I understand that Ms. Hulit has to leave, and I apologize again for running over because of votes. Ms. Hulit, we ask you now to give your testimony. And to the extent you could give your opinion on H.R. 3534, that may preclude any questions on that topic.

STATEMENT OF JEANNE HULIT

Ms. HULIT. Sure. Thank you very much, Chairman Mulvaney and Ranking Member Chu and members of the Subcommittee. I am pleased to be testifying before you today on the topic of surety bonds. And I do want to apologize in advance that I have a flight. I have listened to the other panelists and their concerns and can follow up with them directly, as well as members of your staff, as well as refer things to our Office of Government Contracting and Business Development.

The U.S. Small Business Administration Surety Bond Guarantee Program was established in 1971 to help small businesses obtain surety bonds that are often required as a condition for an award of a construction contract or subcontract. As you know, the federal government requires surety bonds on any construction contract valued at \$150,000 or more. Surety bonds are also required for many state and local government and commercial contracts and subcontracts. In our Surety Bond Program, the SBA guarantees bid, performance, and payment bonds for eligible small businesses that cannot obtain surety bonds through the conventional surety market. SBA's guarantee gives surety companies an incentive to provide bonding for small business contractors whom might otherwise be perceived as too risky to bond without an SBA guarantee. These bonds help small, emerging firms gain access to contracting opportunities in the commercial and government markets.

As many of you know, when the economic downturn occurred a few years ago, construction was one of the hardest hit sectors. In spite of the downturn, however, the SBA Bond Guarantee Program volume grew every year over the past five years. We saw an increase in the number of participating surety companies and agents. When Congress passed the American Recovery and Reinvestment Act in February of 2009, the SBA was given the authority to temporarily increase the Surety Bond Contracting Program to \$5 million as you have heard from some of the other panelists. This change was well received by the surety industry and small business community, and we noticed a significant uptick in bond volume

The Recovery Act infused new life into the Surety Bond Program as seen by the increase in program activity in fiscal year 2010. The total number of bonds guaranteed that year represented a 36 percent increase over the previous fiscal year. In fiscal year 2010, SBA guaranteed a total of 8,348 bonds representing a contract value of \$4 billion.

Building on that success, the SBA has continued to make outreach and awareness of the Surety Bond Program a priority. We have been working closely with our local district offices and industry partners to let small businesses know that they can take advantage of our program.

We have also been listening closely to our industry partners and small businesses on how we can make the program better and more accessible to a greater number of firms. Recently, we developed an automated tool to complement the Electronic Bond Guarantee Application, which we implemented a few years ago. Surety companies, agents, and small businesses can now upload a variety of underwriting documents and transmit them electronically to our field offices. This makes the processing time faster and reduces compliance costs.

This week we published in the Federal Register a proposed rule that would adopt the streamline application process for any bond guarantee on a contract valued up to \$250,000. This new "Quick Application" process will reduce paperwork requirements for smaller contracts. As a result, small businesses and surety agents will navigate the bond application process more easily and cycle time between application approval will be compressed.

We are not stopping there, however. In addition to other agencies in the Administration, the SBA has been tasked with undertaking a full review of our current regulations. In response to industry concerns that certain requirements imposed on surety companies are no longer consistent with industry best practices, our office is trying to update, streamline, and simplify the surety bond regulations.

We look forward to working closely with you and your staff on each of those initiatives. I appreciate the opportunity to testify before you today, and I welcome your questions.

Chairman MULVANEY. Ms. Hult, in light of your time I am going to speak out of order and ask you a very simple question. Has the SBA taken a formal opinion yet on H.R. 3534? Do they have any thoughts on it in general?

Ms. HULT. We have not taken a formal opinion. Our program, as you know, is only for corporate sureties. We do, however, hear a lot from small businesses and the surety industry. And we are happy to talk about what we have learned from those parties with your staff.

Chairman MULVANEY. Thank you very much.

Ms. HULT. You are welcome.

Chairman MULVANEY. If you need to be excused, unless anybody else has any questions, she has a flight, Mr. West.

Ms. HULT. Well, I can stick around for 10 or so minutes if you would like.

Chairman MULVANEY. Okay. Mr. Guerin.

I am sorry.

Ms. CHU. We have questions for the record so we do not have to do them right now but we will direct them to you.

Ms. HULT. Thank you very much.

STATEMENT OF WILLIAM GUERIN

Mr. GUERIN. Good afternoon, Mr. Chairman, Ranking Member Chu. Thank you for the opportunity to be here today.

I, too, got a lot out of the private sector panel and I appreciate the opportunity to listen to their comments before we had a chance to speak.

GSA recognizes the important role small businesses play in driving our national economy. We value the new and innovative solutions that small businesses offer to us as we try to meet today's challenges. GSA has aggressive goals for the participation of small businesses, including small, disadvantaged, women-owned, HubZone, and service-disabled veteran-owned small businesses. In fact, in 2011, GSA awarded 41 percent of all contract dollars to small business. This is well above our goal of 27 percent, and PBS itself obligated more than \$1.05 billion or approximately 39 percent of our dollars to small businesses.

In addition, despite the huge Building Modernization Program that came through the American Recovery and Reinvestment Act, we awarded fully 26 percent of our construction dollars to small businesses in 2011.

Today I would like to focus on the role of small businesses in these new construction major modernization and repair and alterations projects. As a major public real estate organization, our goal

is to maintain a robust inventory that meets the long-term needs of federal agencies. We make investments in this inventory by constructing new buildings and modernizing or repairing existing ones. For each of the last five years, our average request for investments in our inventory was nearly \$1.4 billion. Unfortunately, in 2011 and 2012, those numbers are a lot lower than the average.

There are two ways that PBS seeks to provide small business opportunities in our construction projects. As prime contractors on minor repair and alteration projects and smaller capital program projects, and as subcontractors on our major modernization and new construction projects. Our minor repair and alterations program provides the perfect venue for small businesses. In 2011, the majority of small business construction opportunities were found in our Minor Repair and Alteration Program.

Whenever possible, GSA provides small businesses with prime contracting opportunities. For example, we recently structured a \$46 million recovery act modernization project in the Robert Young Federal Building to allow small businesses to participate. We had a small business designer break the contract into three pieces and we were able to award the three different parts of that contract to small businesses and they would not have been able to compete for the project had it been a single project at a much larger dollar amount.

As subcontractors, small businesses also have the opportunity to work on large new construction and major modernization projects for GSA. For example, we have a number of small businesses who are assisting us with the construction of the new Department of Homeland Security Campus at St. Elizabeth's. About 42 percent of the total dollar value of contracts for that project is going to small businesses, and about 10 percent of those businesses are 8A firms.

All of the large prime contractors on projects exceeding \$1.5 million must have small business plans. These plans and goals are evaluated during the contract selection process and then they are confirmed after the award. In addition, GSA participates in a Mentor Protégé Program to assist willing prime contractors to mentor small businesses. This program allows smaller firms to team with larger construction contractors. Through this relationship, small businesses can gain more direct experience and better transition into larger projects and contracts.

There are a number of opportunities and challenges going forward. We track our prime contractors for progress towards meeting the goals of their small business subcontracting plans. Commonly in large construction contracts there are many layers of subcontractors. GSA's projects are no different. Progress towards small business goals only count first tier, small business subcontractor. As a result, this creates a challenge in ensuring that the actual dollars awarded to small businesses are accurately reflected.

It is generally more cost-effective for us to pursue major modernization and then to maintain our inventory with numerous small scale repair and alterations projects. But given the current budget environment, we think that the large projects are probably not going to receive much funding and so there will be a lot of opportunity for small businesses there.

Thank you for inviting me to speak with you today. I appreciate the opportunity to discuss GSA's encouraging small business participation on our construction contracts, as both prime and sub-contractors. And I welcome any questions you have.

Chairman MULVANEY. Thank you, Mr. Guerin.

Ms. Chu.

Ms. CHU. Ms. Hulit, do we still have you?

Ms. HULIT. Five minutes.

Ms. CHU. Five minutes. Okay. I will make this quick then.

You talked about the increase of the Bond Guarantee Program from \$2 million to \$5 million as a result of the American Recovery and Reinvestment Act. And, of course, it was a temporary increase and expired in September 2010.

Now, you talked about an overall increase of 3 percent for businesses that applied during that period of time. But I wanted to know how many small businesses took advantage of that higher ceiling, the amount that was above \$2 million?

Ms. HULIT. My apologies. We had about 100 businesses take advantage of it at that time. And there were over 663 bids—\$663 million in bids, 51 contracts for about \$145 million.

Ms. CHU. So the 100 businesses represented, that is what percentage of the total amount of businesses that were there?

Ms. HULIT. We had about 1,000 businesses annually participating in the program, so you had 100, so about 10 percent.

Ms. CHU. Okay. And did the SBA see any higher or lower default rates of those contracts or did the rates stay level?

Ms. HULIT. We only had one default of those higher contracts so it was actually a little bit less than our regular rate.

Ms. CHU. That is very good news.

Currently, there are 12 approved surety companies that can issue bonds in the Prior Approval Program, while there are only five companies that issue bonds in the Preferred Program.

Ms. HULIT. Yes.

Ms. CHU. Why are there so few surety companies that participate in the SBA surety bond program?

Ms. HULIT. On the preferred side or on both? On the preferred side our guarantee level is 70 percent. On the prior it is 80 to 90 percent depending on the company. And we hear from industry that the 70 percent guarantee, as you heard from, Mr. McCallum, is also a detriment, particularly in troubled economic times. So 70 percent guarantee has decreased the participation rate on the preferred side. On the prior approval side we had seen a decline over the last 10 to 15 years in participation in our program. And that was largely due over an historical period that we closed some offices. Our cycle times in terms of application and honoring guarantees were very delayed and it caused cash flow problems in the industry. As you see, in the last five years we have turned that corner and our bond volume is growing again and our surety participation is growing. So we have addressed those concerns. Our cycle times are much, much more reasonable. And, you know, we are hoping to get more surety companies participating.

Ms. CHU. Very good. Thank you.

Mr. Dalton.

Chairman MULVANEY. Ms. Hulit, if you would like to be excused.

Ms. HULIT. Thank you. I appreciate very much your understanding.

Ms. CHU. Mr. Dalton, I was surprised to see that you do not bundle contracts and have not done so in the last two years. Did you bundle before that time?

Mr. DALTON. I am not aware of us bundling contracts even before those last two years. I had a chance to go back and verify and check for the last two years and that was something I could definitely state in my written testimony. Bundling contracts within the Corps is something that is certainly frowned upon. And if we wanted to bundle contracts, the Corps of Engineers would have to seek and receive approval to do so. The Corps has a program and a process very similar that we would follow for consolidation of contracts just as we would follow if we were bundling contracts. But the specific reason for mentioning two years is that is as far back as I had a chance to go back and verify.

Ms. CHU. So it was not necessarily a change in policy?

Mr. DALTON. No. Absolutely not. In fact, I feel pretty safe in saying that our policy has always been that we do not bundle contracts.

Ms. CHU. I see. And Mr. Guerin, you do bundle contracts then in GSA?

Mr. GUERIN. No, we do not, ma'am.

Ms. CHU. Oh, you do not either?

Mr. GUERIN. No.

Ms. CHU. Okay. And is this a change in policy or you have never done that?

Mr. GUERIN. There are instances in the past where bundling occurred but it is not a common practice of GSA and it does require additional levels of approval for us to do that. So we do not do bundling.

Ms. CHU. Is the disincentive this additional scrutiny?

Mr. GUERIN. No. It is the nature of what we build. We have large projects, typical single building projects where bundling really is not necessary to accomplish what we need to accomplish.

Ms. CHU. Okay, very good. Construction contracts can oftentimes be out of the reach of small businesses because of the large capacity needed to complete the project, and Mr. Guerin, in your testimony you gave an example of PBS breaking up a construction project into three smaller projects that could be performed by small businesses. Why are not agencies using this type of acquisition strategy more often so that small businesses can compete on more solicitations?

Mr. GUERIN. I do not know, ma'am. I do not know that they are not doing that. It is just an example that we had that is very timely in terms of the discussion today. But we do that fairly frequently where we have opportunities to break a project up. There are needs to go for a larger, single contract where we are doing a large building that is very disruptive to the building, it is disruptive potentially to the tenants in the building, so we want to get in and out of that building as quickly as possible. So we try to go with a general contractor who marshals the forces, makes sure that all the issues and, you know, possible challenges that come up are addressed. But where we have an opportunity we do break the

projects down, so we have opportunities to get small businesses into our contracts.

Ms. CHU. And Mr. Dalton, do you have any similar experience with breaking up such kind of contracts?

Mr. DALTON. Absolutely, we do. As a matter of fact, as was mentioned by or recommended by the previous panel, if you have a MATOC contract, that we should look for similar opportunities for small business opportunities the same way we would create an unrestricted MATOC. We absolutely do the same thing we just talked about. We work with the small business community, the SBA as well as with the surety companies and contractors to determine what is doable by the small business community. And so, over the past several years what we have done is when we created those unrestricted MATOCs, we also created small business MATOCs. For instance, I can remember down at our southwestern division starting in the Fort Worth area, is that we worked with the surety companies to determine what amount we could put out for small business MATOCs. For set-asides I think we had a limit of \$20 million and then we looked for 8A set-asides of \$15 million. And also down to the service-disabled vets I think that was about \$8 million.

When we set up these MATOCs, we include in those MATOCs those projects on which small business can actually compete. We also look at the different subcategories within small business so that we are not just creating one size fits all. And when we put together our acquisition plans for those large procurements over the last several years, it is always keeping in mind what small business can actually execute so that we do not go too far on one side or the other.

And finally, the last thing I would mention, because we keep discussing bundling versus consolidation, one of the things that we look at under consolidation is to make sure that we do not consolidate projects that used to be available to small business and consolidate those to where they are no longer available, executable by small business. So we certainly try to keep small business in mind.

Ms. CHU. Thank you. I yield back.

Chairman MULVANEY. Thank you, Ms. Chu.

Mr. West.

Mr. WEST. Thank you, Mr. Chairman and Ranking Member.

Mr. Dalton, we heard a lot of people previously talk about this reverse auction process or policy. Do you have any policy on that whatsoever?

Mr. DALTON. We do not believe that, for the type of projects that we execute within the Corps, that it is applicable or useful to use reverse auctioning. There are a couple of cases where we actually tried to use reverse auctioning when it was mostly based on looking at materials such as borrow materials in the New Orleans area and we found we had problems with it. We think reverse auctioning works best in categories where you are buying products or supplies more so than construction. Construction is a little hard to do with reverse auctioning.

Mr. WEST. The other question is a pretty good payment schedule, payment rate as far as the prime contracts. Do we still also have a pretty good, as far as the small business contractors, an on-time payment plan with those or schedule?

Mr. GUERIN. In fact, the numbers that I quoted before the percentage, the 98.5 percent payments on-time, that includes both small business as well as large businesses.

Mr. WEST. All right. And Mr. Guerin, can you give us an idea as far as percentage that you are trying to include small businesses in the GSA modernization construction products?

Mr. GUERIN. What our goals are?

Mr. WEST. Yes.

Mr. GUERIN. Our goals are 39 percent in PBS for small business.

Mr. WEST. How close are we?

Mr. GUERIN. We are over that.

Mr. WEST. Good.

Mr. GUERIN. I am sorry. We are at 39 percent. I think our goal is 27 percent.

Mr. WEST. Okay. I yield back.

Chairman MULVANEY. Very quickly in the interest of everybody's time. Gentlemen, you heard first off, actually, Mr. Dalton, because you are using a term that I am not familiar with, which is consolidation versus bundling. Can you help me understand the difference between those two things?

Mr. GUERIN. Bundling, the way we look at bundling is that if we—if opportunities that were previously available to small business, we take those and add projects together and they are no longer available to small business, meaning that if before small business could bid on two barracks at \$25 million, we add those together and now it is a \$50 million project beyond a small business cap there, then that would be—I would consider that bundling. The consolidation would say combine projects together but they still do not exceed the amount that was previously available for small business to bid on.

Chairman MULVANEY. So it is a similar thing; it is just in a different scope then? Consolidation would be smaller than bundling?

Mr. GUERIN. I do not know that I would say consolidation is smaller. It is just that when we add those projects together we do it in such a manner to make sure we do not exclude or eliminate small business from opportunities that they previously had.

Chairman MULVANEY. And since it does not violate the definition of bundling it would be something—okay, that I understand. Thank you for that clarification.

Gentlemen, both of you heard some testimony earlier today that was extraordinarily enlightening to me. And one of the specific reforms that you heard suggested or offered was to allow you to credit against your small business requirement; small businesses that participate at lower than first tier subcontractors. Is there any objection to that? Is there any reason that that should not have been done already? Is there something that I am missing because that seems like a fairly commonsensical reform. But I will throw it open to you as to whether or not you think that might have any potential pitfalls that are not readily apparent.

Mr. GUERIN. We think it gives a more accurate reflection of how many dollars are going to small businesses.

Chairman MULVANEY. The way it is now?

Mr. GUERIN. No, with the changes that were discussed earlier. And I do not think GSA would have any objection to that.

Chairman MULVANEY. Mr. Dalton.

Mr. DALTON. I would say that we would want to move carefully with making that change. While I certainly would agree that it gives more visibility to small business awards, what we would want to be careful I think with is that we do not want the prime contractor to handoff without any responsibility for small business or to help mature and train small businesses' subcontractors on how to do business. And one concern would be that if I had let us just say a 50 percent subcontractor to small business responsibility that I as a prime may hand off all of that to a large business subcontractor and place the responsibility on that subcontractor. What we would probably prefer, I think as one way to look at that is a certain percentage would still and probably should be required from the prime to that sub, the first-tier sub. Certainly collecting and adding all of it up would add more visibility to it but I would just suggest we be real careful.

Chairman MULVANEY. That is an excellent point. I never thought about that, effectively delegating your small business responsibilities through somebody else. Thank you for that. I appreciate that.

Finally, Mr. West asked about reverse actions. Ms. Biondo, who was here previously, I do not know if she is still here or not, had mentioned the multiple best and final offer projects. And again, all I am really concerned about from the taxpayers' long-term interest is whether or not those rules are published in advance. So when you say you do not use reverse auctions, do you tell people about that before they bid on a service contract, on a construction contract?

Mr. DALTON. I cannot speak accurately on the service contracts. I am just not as familiar with those and I am not sure we use that within the Corps but I can certainly check and verify.

Chairman MULVANEY. On construction contracts.

Mr. DALTON. On the construction contracts, they are notified in advance. I can only think of one case that we tried reverse auctioning and really it is not our policy. In fact, our policy is to not use reverse auctioning.

Chairman MULVANEY. Is that policy made public?

Mr. DALTON. I do not know that is. Maybe it is more of a practice than a policy. I would have to verify that. But the reason why we do not, is because construction is not one of those type of commodities. In fact, it is not a commodity, but it certainly makes it difficult to use reverse auctioning for something where you do not know the qualifications of companies, et cetera.

With regard to best and final offers, that is something that companies would know in advance before we would do that.

Chairman MULVANEY. Mr. Guerin.

Mr. GUERIN. GSA uses best value. We do not go for reverse auctioning. I agree with everything my Corps colleague said. The construction really does not lend itself to that. We go after technically qualified firms and then we evaluate price typically.

Chairman MULVANEY. But if I am bidding on a project, do I know what those rules are in advance?

Mr. GUERIN. Yes. In advance you would know how we are intending to award the contract.

Chairman MULVANEY. Gentlemen, I will just close by saying this. One of the things that has become apparent to me since I have been involved in this Subcommittee is that I have been overwhelmed with the response that many government agencies have to small business, and both your organizations stand at the top. I am not surprised to hear the numbers. I was not familiar with them, but both the GSA and the Army Corps have done a tremendous job. And I really do appreciate your commitment to small business. And thank you for allowing us to help small business succeed.

So with that, unless there is anything else, we will adjourn. Everyone have a nice weekend. Thanks again. I apologize for running over.

[Whereupon, at 12:45 p.m., the Subcommittee hearing was adjourned.]

**NATIONAL ASSOCIATION OF SURETY BOND
PRODUCERS**

Testimony of Mark H. McCallum
Chief Executive Officer

Before the U.S. House of Representatives
Committee on Small Business
Subcommittee on Contracting and Workforce

On

Construction Contracting: Barriers to Small Business Participation



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February 9, 2012

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The National Association of Surety Bond Producers (NASBP) is a national trade organization of professional surety bond producers, whose membership includes firms employing licensed surety bond producers placing bid, performance, and payment bonds throughout the United States and its territories. NASBP wishes to extend its appreciation to Chairman Mulvaney, Ranking Member Chu, and to the members of the Subcommittee on Contracting and Workforce of the U.S. House of Representatives' Committee on Small Business for the opportunity to provide written and oral testimony on issues of importance to federal contracting opportunities for small businesses. Our testimony will center on policy issues which, in our opinion, will provide greater protection to and resources and opportunities for small construction firms.

By way of background, our testimony will begin with a brief description of the important role surety bonds play in the federal procurement arena.

The Importance of Surety Bonds: Sound Public Policy

Corporate surety bonds are three-party contract agreements by which one party (a surety company) guarantees or promises a second party (the obligee/federal government) the successful performance of an obligation by a third party (the principal/contractor). In deciding to grant surety credit, the surety underwriter conducts in-depth analysis, also known as prequalification, of the capital, capacity and character of the construction firm during the underwriting process to determine the contractor's ability to fulfill contractual commitments. *Surety bonds are an essential means to discern qualified construction companies and to guarantee contracts and payments, ensuring that vital public projects are completed, subcontracting entities are paid, and jobs are preserved.*

The federal government has relied on surety bonds for prequalification of construction contractors and for performance and payment assurances since the late nineteenth century. In 1894, the U.S. Congress passed the Heard Act which codified the requirement for surety on U.S. government contracts and institutionalized the business of surety. In 1935, the Heard Act was superseded by the Miller Act, which required the continuation of these vital assurances so that U.S. taxpayer funds were protected and subcontractors and suppliers would receive payment for their labor and materials. Today, the Miller Act and applicable regulations require that, before any contract exceeding \$150,000 is awarded for a federal construction contract, the prime contractor must furnish a performance bond and a payment bond to the contracting agency.

Types of Surety Bonds

The bid bond assures that the bid has been submitted in good faith and the contractor will enter into the contract at the bid price and provide the required performance and payment bonds. A performance bond protects the project owner from financial loss should the contractor fail to perform the contract in

accordance with its terms and conditions. The payment bond protects subcontractors and suppliers, which do not have direct contractual agreements with the public owner and which would be unable to recover lost wages or expenses should the contractor be unable to pay its financial obligations. Often, small construction businesses must access the federal procurement marketplace at subcontractor and supplier levels, and the payment bond is their primary recourse and protection in the event of prime contractor nonpayment or insolvency.

Role of the Bond Producer

The bond producer plays a vital role in the federal construction process. The bond producer stands as the “bridge” between the construction contractor and the surety company. The bond producer works closely with the construction business as an advisor, educator, and match maker to position the business to meet underwriting requirements in order to obtain surety credit.

The objective of the producer is not only to assist the contractor with obtaining surety credit for each contract requiring surety credit but to ensure that the contractor’s business remains viable and thrives for years to come. To that end, bond producers assist construction firms of all sizes with creating networks of knowledgeable professional services providers, such as construction attorneys, certified public accountants familiar with construction business practices, and construction lenders, and may assist construction firms with market intelligence and even strategic and succession planning.

Assist Small Businesses: Enhance the U.S. Small Business Administration’s (SBA) Bond Guarantee Program

The SBA Bond Guarantee Program (Program) was created to ensure that small and emerging contractors, which, for various reasons, do not qualify in the standard surety market, have a means by which to gain access to surety credit. The Program provides guarantees, ranging from 70 to 90 percent, to participating surety companies as an inducement to extend surety credit to these construction firms. The construction firm and the surety company pay fees to access the Program.

The Program has been serving small businesses for decades and continues to be a necessary and needed federal program. In recent years, the SBA has undertaken incremental efforts to improve the functioning and the appeal of the Program, making strides, for example, in improving its application processes and procedures, its response time to claims, and expanding the Program’s reach to include design-build contracts. NASBP applauds the SBA for taking these important steps. In the opinion of NASBP, however, much more can and needs to be done so the Program can fully realize its potential to assist small businesses. The SBA Bond Guarantee Program is an example of a good federal program that deserves to get better to continue to achieve its mission.

Legislative and Regulatory Enhancements

NASBP offers recommendations for enhancements to the Program below.

- Increase the SBA guarantees to sureties across the board to 95% of the bond amount for 18 months, then reduce the guarantee across the board to 90% thereafter.
- Increase the size of contracts that can be guaranteed through the Program to \$5 million; the contract threshold currently is \$2 million.
- Provide statutory discretion to the Administrator to determine liabilities assumed by the Program, so that a denial of a guarantee can be partial, reflecting the amount of the prejudice suffered by the SBA, and not a complete denial of the entire guarantee in every instance.
- Require the Administrator to reduce or waive fees paid by contractors and sureties in the Bond Guarantee Program for 18 months, with authority to extend the time period for such actions.
- Provide assistance to small construction firms, particularly to women-, minority- and veteran-owned construction firms, for the purpose of providing them financial means/incentives to access professional services providers such as construction lawyers and construction accountants.
- Create a system of due process in connection with the SBA Bond Guarantee Program so that sureties receive notice, a hearing, and right to appeal if: 1) the SBA denies a surety's request to participate in the Program or eliminates a surety from the Program, or 2) denies a claim under a bond that the SBA has guaranteed.
- Require the SBA to track the contractors that participate in the program.
- Ensure that the SBA Bond Guarantee Program regulations keep pace with changes in law and practice in the construction and surety industries.
- Ensure that the Program has adequate resources to market itself to small construction businesses and to state and local agencies assisting such businesses.

NASBP supported the enhancements to the Program adopted under the American Recovery and Reinvestment Act (ARRA), which included increasing the contract size that can be guaranteed through the Program from \$2 million to \$5 million, and up to \$10 million if a federal agency's contracting officer certifies that the guarantee is necessary, and vesting discretion in the Administrator to determine the Program's liabilities. These enhancements expired on September 30, 2010. NASBP believes that they should be made permanent.

Construction firms, particularly those that are small and emerging, still face an exceedingly difficult construction market for the foreseeable future. Reducing the fees paid by contractors to access the Program and providing assistance with retaining professional services providers would be significant steps to position these businesses to qualify for surety and financial credit. Such enhancements could be taken on a limited time basis to help small construction firms weather

the current, difficult economic environment, boosting this particularly hard-hit industry.

Other proposed enhancements are for the purpose of removing barriers to surety company participation in the Program. The Program should offer a uniformly high guarantee percentage that makes business sense to surety companies. Without such a high guarantee, such as 90%, surety companies will be hard pressed to make the internal business case for underwriting firms that otherwise do not qualify for surety credit. Further, the Program's existing regulations are out of step with prevailing practices of the construction and surety industries. Current SBA regulations, for example, require notice to the SBA from the surety company of change orders exceeding a certain dollar amount or percentage of the contract amount, but most construction contracts, including commonly used standardized forms, such as those published by the American Institute of Architects and by ConsensusDOCS, include boilerplate language requiring the surety to waive notice of increases in contract amount. As a result, sureties routinely are not informed of all contract increases and are not in position to provide the SBA with notice of all changes in the contract amount. The failure to inform the SBA of such changes constitutes grounds for the complete denial of the surety's guarantee. Moreover, the Program does not include a structured process for surety companies to contest the denial of a previously-approved guarantee. At the very least, surety company participants should have a delineated means by which to have their concerns or positions heard by the Program.

NASBP believes that the proposed enhancements to the Program would create additional opportunities for small and emerging contractors and additional incentives for more sureties and agents to assist small contractors in obtaining their first bonds and graduate them from the SBA Surety Bond Guarantee Program into the traditional surety market.

**Educate Small Businesses: Encourage Industry & Government
Partnership on Bonding Awareness & Education**

Industry and government can work together to provide small and, particularly, emerging construction firms with bonding awareness and education. Many such firms simply do not understand the resources that presently exist for them at the federal level. Also, state and local governments often are unaware of federal programs for emerging construction businesses, such as the SBA Bond Guarantee Program, and may seek to create duplicative and unnecessary programs. NASBP urges that Congress make building such awareness a policy goal of the federal government.

In recent years, NASBP together with the Surety & Fidelity Association of America (SFAA) and in partnership with federal agencies, such as the U.S. Department of Transportation, and with various state and local agencies have been engaged in bonding education programming for small and emerging

construction businesses throughout the United States. This past year, NASBP producers worked with SFAA and the U.S. Department of Transportation at eleven bonding education programs throughout the country. An equal number of programs are planned for 2012. These programs, first developed by SFAA, can vary in duration, but typically are offered over the course of eight to ten weeks, acquainting small and emerging construction firms with the business and risk management processes needed for their success and growth and acquainting them with the prerequisites for obtaining surety credit. Subject matter experts drawn from the local construction and surety communities serve as volunteer instructors, providing attendees often with first contacts to important resources for their businesses. Programs like these need to be a component of the outreach efforts of other federal contracting agencies. NASBP would like to assist federal contracting agencies interested in pursuing these awareness and education programs.

**Protect Small Businesses: Support H.R. 3534,
the Security in Bonding Act of 2011**

NASBP strongly supports H.R. 3534, the "Security in Bonding Act of 2011" as a critical means to protect small businesses and to assure the integrity of surety bonds on federal contracts when issued by individuals using a pledge of assets. As noted earlier, the Federal Miller Act requires contractors to furnish surety bonds on federal construction projects to ensure that bonded contracts will be completed in the event of a contractor default, thereby protecting precious U.S. taxpayer dollars and subcontractors and suppliers, many of which are small businesses. The financial stability of the surety is the key to the success of the surety bonding system.

Presently, there are three methods construction firms may use to furnish security on a federal construction project:

1. By securing a bond written by a corporate surety, that is vetted, approved, and audited by the U.S. Department of Treasury and listed in its Circular 570;
2. By using their own assets to post an "eligible obligation," i.e. a U.S.-backed security, in lieu of a surety bond. The security is pledged directly and deposited with the federal government until the contract is complete; or
3. By securing a bond from an individual, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property.

It is this third alternative that has proven consistently problematic, to the financial detriment of contracting authorities and of subcontractors and suppliers. NASBP believes that the current regulations pertaining to use of individual sureties on federal construction projects are flawed and allow gamesmanship by unscrupulous persons acting as sureties and, therefore, need to be superseded by the statutory approach delineated in H.R. 3534.

Federal Acquisition Regulation (FAR) 28.203-2(b)(3) permits federal contracting officers to accept bonds from natural persons, not companies, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property. These individuals neither are subject to the same scrutiny and vetting given to corporate sureties nor are they required to provide physical custody of the asset to the government that they pledge to secure their bonds to the contracting authority.

This lack of thorough scrutiny of individual sureties and control over their pledged assets has resulted in a number of documented situations where assets pledged by individual sureties have proven to be illusory or insufficient, causing significant financial harm to the federal government, to taxpayers, and to subcontractors and suppliers, many of whom are small businesses wholly reliant on the protections of payment bonds to safeguard their businesses.

Federal requirements do mandate a level of documentation and information from individual sureties. Individual sureties are required to complete, sign, and have notarized an affidavit of individual surety (SF 28), which is a standardized form for the purpose of eliciting a description of the assets pledged and the contracts on which they are pledged. SF 28, however, does not elicit other pertinent information, such as that about the character or fitness of the individual acting as surety, like criminal convictions, state insurance commissioner cease and desist orders, or personal bankruptcies.

Under FAR requirements, the pledged assets also are supposed to be placed in an escrow arrangement by the individual surety, subject to the approval of the contracting officer. The individual surety, however, is not required to turn the assets over to the physical custody of the contracting authority. Each contracting officer, not the Department of Treasury, shoulders the entire burden of determining the acceptability of the individual surety, its documentation, the escrow or security arrangement, and the value and adequacy of pledged assets, and must do so in relatively short order to progress the contract procurement. A missed, incorrect, or forsaken step may mean the acceptance of a fraudulent or insufficient bond, rendering its apparent and much needed protection worthless.

This burden of assessing individual sureties is added to the already considerable responsibilities of contracting officers. They are required to determine the authenticity of the documentation of the assets pledged to support the individual surety's bond obligations and to verify that the pledged assets actually exist, are sufficient, and are available to the federal government. They have to know that a particular financial document is what it purports to be and to understand and to assess the different types of collateral, such as stocks and real estate located anywhere in the United States.

It is not clear if and how often federal contracting officers receive specific training to understand and to perform the needed tasks of examination concerning individual sureties. Documents of federal agencies suggest that there are occasions when federal contracting officers may not have a complete understanding of what is required of them to safeguard taxpayers and small businesses from individual surety fraud. The Financial Management Service of the U.S. Department of Treasury issued a "Special Informational Notice to All Bond-Approving (Contracting) Officers" on February 3, 2006, still posted on the web site for the Financial Management Service at http://www.fms.treas.gov/c570/special_notice.pdf. This informational notice was directed to federal contracting officers to remind them of the applicable FAR requirements governing individual sureties. Specifically, the notice, a copy of which is attached to this testimony, states in part:

"Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where individual sureties are listing corporate debenture notes and other questionable assets on their 'Affidavit of Individual Surety', Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit."

Likewise, the U.S. Department of the Interior issued a notice to its contracting officers in 2009 to remind them of FAR requirements associated with acceptance of individual surety bonds. This notice, titled "Department of the Interior Acquisition Policy Release (DIAPR) 2009-15," states that the Department of the Interior Office of Inspector General conducted an investigation of contracting personnel practices concerning individual sureties and found concerns. Specifically, the release, a copy of which is attached to this testimony, states in part:

"The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System."

If a contracting officer fails to perform adequately the necessary investigation of an individual surety, and the individual surety pledges assets that do not exist, are insufficient, or are not readily convertible into cash to pay the obligations of the defaulted general contractor, everyone on the project from the contracting agency on down is left unprotected and at risk for financial loss. If the assets

pledged to support the bonds are uncollectible, unpaid subcontractors and suppliers protected by the bond will suffer financial hardship and could, in turn, default and go into bankruptcy.

Improper Individual Surety Activity

Recent situations illustrate where individual surety bond assets have turned out to be inadequate, illusory, or unacceptable. One illustration is *United States ex rel. JBlanco Enterprises Inc. v. ABBA Bonding, Inc.*, where, in spite of a March 11, 2005 cease-and-desist order from the Alabama Insurance Department, Mr. Morris Sears was able to submit bonds on a federal contract in Colorado supported by an affidavit (Standard Form 28) stating that ABBA Bonding had assets with a net worth of over \$126 million. Although no assets were placed in escrow for the benefit of the government, the U.S. General Services Administration accepted the bonds anyway. Mr. Sears eventually filed for Chapter 11 bankruptcy in the Southern District of Alabama, and it was made clear from the bankruptcy proceeding and legal depositions that most of the \$126 million never existed. JBlanco Enterprises, a small business subcontractor performing work on federal contracts, nearly was forced to declare bankruptcy as a result of a deficient individual surety bond placed on a federal project that later proved to have no assets behind it.

Another notable instance surfaced in March 2010, when George Douglas Black, Sr., an individual surety doing business as Infinity Surety, was arrested and charged by the U.S. Department of Justice with mail fraud for allegedly selling more than \$25 million of worthless construction bonds to 150 different construction companies on local, state, and federal public works projects, while receiving \$2.9 million in fees. Among Black's alleged victims were the U.S. Department of Navy, the Beaumont Independent School District of Texas, and the Monroe Airport in Monroe, Louisiana. It is alleged that Black repeatedly pledged the same small piece of real property to insure multi-million dollar state and federal construction contracts.

These, unfortunately, are not isolated instances. Other examples exist, both past and present, showing where individual surety bond assets proved illusory, uncollectible, or deficient.

Legislative Solution

H.R. 3534, the "Security in Bonding Act of 2011," is a common-sense solution to this problem. The bill requires individual sureties to pledge solely those assets defined as "eligible obligations" by the Secretary of the Treasury and to provide those assets to the federal contracting authority, which will deposit them in a federal depository designated by the Secretary of the Treasury, ensuring that pledged assets are sufficient, convertible, and in the physical custody and control of the federal government. This is nothing more than what now is statutorily required of contractors who wish to pledge collateral as security on a federal contract in lieu of a surety bond.

If enacted, H.R. 3534 will eliminate the gamesmanship inherent in the current regulatory system governing individual surety bonds and will remove a considerable administrative burden from federal contracting officers. Small businesses working on a construction project—either as subcontractors, suppliers, or workers on the job—have no control over the prime contractor's choice of security provided to the federal government, but they suffer the most harm financially if the provided security proves illusory. The result of this bill is that small contractors, subcontractors, and suppliers on federal construction projects will know that adequate and reliable security is in place to guarantee that they will be paid.

**Position Small Businesses: Include New
Construction in Contract Bundling Scrutiny**

The Small Business Reauthorization Act of 1997 defines contract bundling as “consolidating two 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 that is unlikely to be suitable for award to a small business.” In order to justify contract bundling, according to 15 U.S.C. §644(e), federal agencies must demonstrate “measurably substantial benefits,” such as cost savings, quality improvements, reduction in acquisition cycle times, or better terms and conditions.

In *Tyler Construction Group v. U.S.*, 83 Fed. Ct. 94, a federal contracting agency called into question whether anti-bundling rules apply to procurements for new construction. In deciding the case, the U.S. Court of Federal Claims stated, “whether the bundling provisions of 15 U.S.C. §631(j) should or do apply to acquisitions for new construction is a question we leave to Congress.” Clearly, the U.S. Court of Federal Claims opinion sends a message that, without legislative intervention, contracting agencies need not place procurement of new construction on the same footing for scrutiny of improper contract bundling as other procurements. In “Bundling and Consolidation: Making Sense of It All,” an article published in the October 2010 issue of the *Army Lawyer*, the author writes: “[i]n some cases, agencies may find it less problematic to simply state that the requirements being considered for consolidation are new and, therefore, fall outside the scope of either the SBRA Bundling or Section 801 Consolidation provisions.” Thus, in the current procurement environment, contracting agencies may seek to lessen contract bundling scrutiny simply by casting a procurement bundling small contracts as one for new construction. Use of such tactics would impede or foreclose small business participation at the prime contract level and, ultimately, lessen competition on federal projects.

Legislative Solution

NASBP urges that Congress address this question of the applicability of anti-bundling rules to new construction by introducing legislation that would amend

the statutory definition of contract bundling to specifically include procurements for new construction, so that small construction businesses can more fully participate as prime contractors on federal construction projects. By undertaking this action, Congress would facilitate greater participation of small construction contractors at the prime level in the federal procurement arena; increase the likelihood that contracting agencies will meet or exceed their small business participation goals; and increase competition for federal procurements, thereby providing pricing benefits to the federal government. In short, small construction firms would be given more opportunities to compete for award of contracts which will be within their reach and resources and within their financial capabilities and surety credit.

NASBP appreciates the opportunity to address the Subcommittee on Contracting and Workforce to raise awareness about important issues confronting small construction businesses wishing to perform or performing federal contracts or supplying labor and materials on such projects. NASBP hopes its testimony proves beneficial to the deliberations of the Subcommittee and welcomes any inquiries from the Subcommittee on the matters raised in this testimony or on other matters pertinent to small businesses and surety bonding.



**Testimony of Rosana Privitera Biondo
President
Mark One Electric
On Behalf of Women Construction Owners and Executives**

**Before the
Committee on Small Business
Subcommittee on Contracting and Workforce
United States House of Representatives**

**On
"Construction Contracting: Barriers to Small Business Participation"**

February 9, 2012

Mr. Chairman and Members of the Subcommittee, good morning. My name is Rosana Privitera Biondo. I am the President of Mark One Electric, headquartered in Kansas City, Missouri. I am testifying today in my capacity as President of the Board of Directors of Women Construction Owners & Executives (WCOE), a 28 year old organization whose mission is to create contracting opportunities for our members – women who have chosen to build a business in the non-traditional industry of construction.

Thank you for giving me the opportunity to testify before you today in this very important hearing. WCOE has just completed our Annual Leadership Meeting here in Washington, DC where we gathered our organization's leaders from across the country to discuss issues of importance to them and their businesses. As you know, the lingering economic recession has hit the construction industry particularly hard, and many small businesses in our industry seem to have been hit disproportionately hard. Yet, our members are energized about the future and particularly about new efforts in Congress to intelligently address the problems with federal construction contracting and the various programs intended to promote utilization of small, disadvantaged or woman-owned businesses. As you know, the construction industry is unique and many of our challenges differ from other small businesses. Our testimony will concentrate on construction projects at the federal level, although it is impossible to address federal projects without mentioning the state and local components of the process.

The first important principle is the structure of our contracting work. Both public and private construction projects are awarded to a prime contractor who is then responsible for subcontracting out the majority of the work to specialty contractors. Federal construction projects are usually much larger than privately funded projects. According to a search on USASpending.gov, the top five prime contractors performing construction related work received between \$712 million and \$1.2 billion in FY2010.

WCOE is intent on ensuring that our women-owned construction companies receive their fair share of subcontracts on these major federal construction projects. While the prime contractors will solicit bids from us and will include us as subcontractors in the final bid submittal, once the government has issued the contract the prime contractor will often "bid-shop" the subcontractor bids. It is not uncommon for the prime contractor to make a last minute substitution of a lower bid subcontractor and keeping the difference. WCOE would prefer that the agency's contracting officer be informed of and responsible for subcontracting substitutions, which often eliminate women-owned small businesses that were included in the initial bid submittal.

Many federal construction projects are awarded through grants to states, particularly for Department of Transportation projects. The Department of Transportation issues guidelines to states, which include recommendations for utilization of small or minority owned businesses. However states are not compelled to comply, even though they are using federal dollars for the project. We understand the complexities presented by the Adarand Constructors, Inc. v. Peña, 515 US 200 (1995) but we believe a uniform standard could be implemented and no state should be permitted to have goals below the federal standard.

We realize this is a complicated area and affects other Congressional Committees, but we felt it was important to bring this issue to this Committee's attention because it has a direct effect on the health of small construction businesses and their ability to create jobs.

The \$46 billion in transportation project funding included within the stimulus package could have been a much-needed stimulus to women-owned small construction businesses – and indeed we thought it would be. However, many states that received the funding have refused to incorporate provisions for small or woman-owned business participation. We know the Congressional intent was there, but the implementation on the state level did not happen.

Let me just take a few minutes to highlight two issues where the well-intentioned federal small business programs do not apply to small construction companies.

First, the women owned small business (WOSB) procurement program. It took the efforts of thousands of women owned businesses and dozens of organizations that represented them to persuade the SBA to implement the program enacted by Congress 11 years ago. This program allows for restricted competition for women owned companies that seek prime contracts. While this program will benefit many women owned businesses, WOSBs in the construction industry fear it will be of limited benefit, even though 61 six-digit NAICS codes connected with WCOE members are included in the program.

The WOSB program has a contract award limit of \$4 million for construction NAICS codes. This contract limit confines women-owned small businesses to compete for very small federal construction contracts. Let me explain. In FY2010, the federal government awarded 165,269 construction-related contracts with a dollar value less than \$4 million for a total of \$19.5 billion. The average contract award was \$118,085. When you look at the complexity of the paperwork required on bid submittals and progress payments compared to the small profit percentage allowed on federal projects, it is extremely difficult to net out at anything other than a break-even on these small projects. Yes, the quantity of projects were there – but the quality of the projects is seriously lacking.

On the other hand, construction related contracts worth more than \$4 million are a different story. In FY2010, 2,125 contracts were awarded with a total value of \$35.2 billion. The average contract value was \$16.6 million. This demonstrates the vast difference between the size of the awards at the \$4 million threshold that the WOSB program stipulates and the size of awards above that total. Women-owned small businesses – especially women in the construction industry – will continue to be at a disadvantage, so long as the size limits for awards remain in place. The WOSB program simply will not work unless the dollar limits for awards are removed. This really will take an Act of Congress, since Congress put the limits in place. Thankfully, we understand that legislation will be introduced shortly in this Committee to remove those caps. We will work diligently to gather support from the community and Congress to pass this legislation because it is the only way this program can assist the women that we represent in securing federal work. Other small business programs which restrict competition, such as the 8(a), Veterans, HUBZone, etc. do not have award caps. We believe it is only equitable that the women construction owners in this country are afforded the same opportunity to contract with the federal government.

The second example is also about size and related to the WOSB program. The program, as well as all of the good work that this Committee has done and will continue to do, is only applicable to businesses that are defined as small. That determination is made by SBA's Office of Size Standards. SBA size standards are based on either revenue or number of employees. Currently, the SBA size standard for construction is based on a revenue standard of \$7.0 to \$14.0 million for specialty subcontractors to \$33.5 million for

prime contractors. That severely limits the amount of available construction projects in the Federal sector that will be eligible for the "small" designation. WCOE believes that gross annual revenue is no longer a relevant determinant of whether a business is small or not in the construction industry. In today's construction industry, over 50% of a project cost is in materials and every business publication provides monthly reports about the steadily increasing costs of building materials.

WCOE believes a more accurate determinant for size standards in the construction industry (NAICS section 23) would be employee based (FTE) as it is for the majority of other NAICS sections. The SBA has a complicated economic formula for calculating its revenue based size standards and WCOE has neither the resources nor the Masters in Economics to defeat SBA's arcane mathematical formula. However, we do have on-the-ground experience and we can tell you that the revenue-based size standard severely restricts our ability to take advantage of programs Congress has put into place to assist us growing our businesses and creating jobs.

We would like to offer a suggestion that an alternative way of calculating the employee standard by a relatively simple formula that OSHA uses. All of our members have to file an OSHA 300 form which contains a formula to calculate full time employees (FTE). The formula takes the number of employees paid and divides it by the number of pay periods to arrive at the FTE number.

Given the importance of subcontracting to members of our organization, we applaud Chairman Graves for introducing the Government Efficiency through Small Business Contracting Act of 2012 (GET Act). While we certainly support raising the overall small business goal from 23 to 25 percent, raising the subcontracting goal from 35.9 percent to 40 percent of the total value of all subcontracting awards is one of the keys to our members' success. We also believe that senior officials of agencies should be held accountable for meeting Congressionally mandated goals, so we support the provision that prohibits them from receiving bonuses if the agency has not met its small business contracting goals.

We also support the legislation introduced by Representative Mulvaney, H.R. 3893, which further strengthens the subcontracting law by imposing substantial penalties to primes that do not file their subcontracting plans. Although the Small Business Jobs Act prohibits the practice of switching subcontractors upon an award, this bill puts additional teeth into the law.

WCOE also believes there is room for a mid-tier contracting program. In order to be a successful federal construction contractor, it is necessary to have considerable financial assets available because of bonding requirements. Although our members are small compared to our competition that secure the bulk of federal construction dollars, many WCOE members do not fit within the small business size standards. So, we are in limbo. Not big and not small. Anyone who is knowledgeable about federal contracting knows that this not an enviable position to be in. Mid-size companies would be in a much better position to identify small businesses with whom to subcontract, thereby assisting them in growing their businesses and creating jobs. Legislation pending in Congress calls for a mid-tier pilot program and we urge the Committee to take a close look at structuring a program for the construction industry. Lastly, there are two access to capital issues that we would like to address—retention and bonding. We refer to these issues as access to capital issues

rather than contracting issues for a reason. The policy surrounding retention and bonding have a direct effect on the success of our businesses to compete on federal projects.

Retention is the process of holding back a portion of the contract until the work is completed. While that is an accepted practice in construction, it can tie up capital for smaller firms unnecessarily. We would ask that on federal projects, the amount a prime can hold back from a sub should not be a percentage, but rather the amount necessary to cover the work in question. Here's what the FAR 32.103 says about retainage:

32.103 Progress payments under construction contracts.

When satisfactory progress has not been achieved by a contractor during any period for which a progress payment is to be made, a percentage of the progress payment may be retained. Retainage should not be used as a substitute for good contract management, and the contracting officer should not withhold funds without cause. Determinations to retain and the specific amount to be withheld shall be made by the contracting officers on a case-by-case basis. Such decisions will be based on the contracting officer's assessment of past performance and the likelihood that such performance will continue. The amount of retainage withheld shall not exceed 10 percent of the approved estimated amount in accordance with the terms of the contract and may be adjusted as the contract approaches completion to recognize better than expected performance, the ability to rely on alternative safeguards, and other factors. Upon completion of all contract requirements, retained amounts shall be paid promptly.

In other words, federal contracts do not require a set percentage of retention and contracting officers should only withhold funds for cause. Subcontractors should not have funds withheld as retention unless the work for which they are responsible is not accepted as complete. WCOE recommends that the amount withheld in such an instance should not exceed the value of the work remaining to be done and should not be set at an arbitrary percentage of the contract. It is important to note that surety bonds cannot be released unless the retention is released, so a contractor's ability to begin a new project is restricted until her assets are released when the bonded work is accepted as complete and she can bond a new project.

Bonding requirements for subcontractors, or dare we say, over-bonding, ties up capital for our members as well. Bonding, unique to the construction industry, is a guarantee of performance on a project which the owner of the construction company must collateralize with business and personal assets—thus tying up precious capital. We urge federal agencies to eliminate the requirement for subcontractors to provide a bond unless it is required of the prime contractor.

In summary, these last few years have been difficult for our industry. Federally funded projects and contracts have been instrumental in keeping our firms viable. We are encouraged by this Subcommittee's commitment to the women owned firms who seek to rebuild their communities by growing their businesses and creating jobs. We look forward

to working with you to address some of the barriers we have identified today. I would be happy to answer any questions.

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.

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Statement of Mr. Dirk D. Haire
Fox Rothschild, LLP; Washington, DC
Subcommittee on Contracting and Workforce
Committee on Small Business
United States House of Representatives
February 9, 2012

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 have 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 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.



Testimony of
Miguel Galarza
President of Yerba Buena Engineering & Construction, Inc.

Before the
United States House of Representatives
House Committee on Small Business

Hearing on

Construction Contracting and the Barriers
Preventing Effective Small Business Participation.

February 9, 2012

Testimony of Miguel Galarza, President of Yerba Buena Engineering & Construction, Inc.
Before the United States House of Representatives House Committee on Small Business
Construction Contracting and the Barriers, Preventing Effective Small Business Participation.

February 9, 2012

Good morning Chairman Mulvaney, Ranking Member Chu and member of the subcommittee.

My name is Miguel Antonio Galarza and I am the President and Founder of Yerba Buena Engineering & Construction, Inc., headquartered in San Francisco, CA, with offices in Salt Lake City, UT. I have served as a State Director for the Association of General Contractors in California and currently serve on the Board of Directors of ICA, also known as the Inner City Advisors.

As a business owner who has risen over the past 30 years from working in the field as a tradesman to filling mid- and senior-level management roles as an employee to currently performing federal, state, and local construction contracts in (8) eight Western states as a prime contractor, I am honored to share my unique perspective on the barriers and challenges that face small and emerging businesses in the construction industry as they relate to bonding, subcontracting goals, and contract bundling.

It is my hope to provide the insight your subcommittee needs to continue the dialog and develop a plan to enact meaningful change to subcontracting goals, contracts that are bundled, and the broadening and strengthening of current bonding availability and bond guaranty programs.

Yerba Buena Engineering was incorporated in Jan 2002 and shortly thereafter, in May of 2003, became 8(a) certified through the U.S. Small Business Administration. Additional certifications that were instrumental to our growth were our local City & County of San Francisco small business certification under the Human Rights Commission and our U.S. Small Business Administration HUBZone certification. Yerba Buena Engineering & Construction, Inc., has been a recipient of 21 ARRA-funded contracts over the past 3 years, contributing to our 30% growth over that time period.

Key to our success, besides the obligatory high standards of quality, safety, and pricing, was the experience I gained from working in the field and for other small 8(a) firms as an estimator and project manager.

My 10-year “apprenticeship” of working for other small, disadvantaged businesses served as a proving ground, honing my negotiation skills, engineering knowledge, and, most of all, my operational knowledge of bonding and banking that would be required to play in the game of federal prime contractor. Unfortunately, far too many tradespeople believe that simply being a good craftsman and providing value to your clients is all you need to be successful. Sadly, this idealistic approach to the federal procurement arena leaves a business owner confused, overwhelmed, and intimidated.

Since our inception in 2002, Yerba Buena Engineering & Construction, Inc., has completed hundreds of projects from Hawaii to North Dakota, with contract revenue in excess of \$112 million in the past 10 years. Ninety-five percent of those projects required us to provide bonding. This growth was accomplished by having the opportunity to find and compete for small projects, growing to larger projects, slowly building our bonding capacity, our cash flow reserves, and our capable personnel to construct the work. This cannot not be accomplished if contract opportunities are bundled for the ease and time saving gained by the contracting community.

While all contract bundling cannot be avoided, what can be done is to put teeth into the subcontracting plans required by large businesses. Under FAR Subpart 19.7—The Small Business Subcontracting Program¹; the statute requires a “good faith” effort to maximize opportunities for small business. But to the small business community, “good faith” really means “no faith at all.” Only by setting mandatory goals for small business inclusion, coupled with serious and real penalties for failing to achieve these goals, can Congress guarantee small firms an opportunity to build capacity and grow their companies, in spite of bundled contract procurement.

This concept is not new and unproven. The State of California, for example, has a mandatory Disadvantaged Veteran Business Enterprise (DVBE) goal of 5 percent on all State-funded construction contracts and a Disadvantaged Business Enterprise (DBE) goal of 13.5 percent on

its federally funded projects². These goals are the minimum standards; contractors who choose to do business in California understand that not meeting these goals is not an option. The same can be said for the City and County of San Francisco. Under the direction of the Human Rights Commission, all construction contracts are subject to mandatory minimum goals, established by market research. A copy of the report for the last quarter (provided with my written testimony) clearly shows that citywide through all its various agencies, San Francisco is on the leading edge of creating and maximizing the opportunities for local business enterprises. This highlights that with a combination of commitment and strong enforcement, the small business community can be included in major procurement programs. Again, the goal here is to provide the contractors that have limited and growing bonding capacity an opportunity to grow their firms to the next level. HRC quarterly report 2010/2011³

This growth in bonding capacity is uniquely supported by the City of San Francisco Surety Bond program. The following are the highlights of this program locally in San Francisco and statewide. The City & County of San Francisco bonding assistance programs are demonstration models that have proven that providing direct and locally delivered bonding support can reduce the bonding barrier and enable contractors to participate and perform with exceptionally low risk.

Since their implementation, these programs have enabled minority and small contractors to secure bonds to bid on \$564 million in public contracts and \$176 million in final contract awards. They have garnered \$11.4 million in owner cost savings from low-bid program contractors. There has been only one default in 15 years with a program loss ratio of .02% (two tenths of one percent) of program-pledged collateral of \$31.3 million.

These results have been achieved with low levels of collateral (average 30%, never exceeding 40%) and use of effective risk management strategies applied through completion of the contract by maintaining an engagement [unclear] of the program contractor, project manager, and project owner throughout.

These programs prove that the removal of impediments and barriers, enabling more contractors to compete, save contracting dollars while achieving the goals of inclusion and stimulating local economic growth by retaining more local public contracting dollars and employing local workers. Meriwether & Williams Presentation⁴.

I would like to share my personal beliefs and opinion on the current status of the U.S. Small Business Administration and its current and future funding requirements, as well as current developments happening at the Department of Commerce and MBDA.

Only by investing in the future of small business can we as a nation continue to grow. Construction as an industry is uniquely positioned to lead in this resurgence. Why?

- Construction cannot be exported.
- The products used in construction are manufactured in the United States, creating jobs on the supply chain locally and nationwide.
- Construction projects create provide solid living wages for tradespeople.

Hence, when funding to SBA is reduced, the opportunity for small business to learn the ins and outs of federal procurement 101 is greatly reduced. SBA is current understaffed and overworked. Great care must be exercised if and when the Department of Commerce mission is changed and the small business technical training of MBDA is moved or considered for elimination. The importance of trained and qualified personnel who are in the business of ensuring small business program participation is highlighted by the recently passed FAA reauthorization. It contains a provision for mandatory training of FAA procurement personnel in the procedures of having and achieving a successful small business project.

On the one hand, I'm pleased to see that an agency the size of FAA recognizes that it lacks the expertise to develop and run a small business project. Still, I'm disappointed that the U.S. Small Business Administration has existed since 1953, and more than 50 years later, we are still trying to figure out how to train personnel to develop a program that works.

Thank you for the opportunity to share with you my experiences. I am proof that small business can succeed and prosper. I would like to thank the committee for the excellent work to date and encourage the committee to continue to fight for small business. We need you support.

References

¹ Subpart 19.7—The Small Business Subcontracting Program. (n.d.). *www.acquisition.gov*. Retrieved February 7, 2012, from /current/html/Subpart%2019_7.html

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³ Human Rights Commission: Policy Division. (n.d.). *Human Rights Commission: Home*. Retrieved February 7, 2012, from <http://www.sf-hrc.org/index.aspx?page=6>

⁴ Meriwether & Williams Presentation on; Bonding assistance programs. PPT 2012



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

TESTIMONY OF

JEANNE A. HULIT
ACTING ASSOCIATE ADMINISTRATOR
OFFICE OF CAPITAL ACCESS
U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
HOUSE COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

"CONSTRUCTION CONTRACTING: BARRIERS FOR SMALL BUSINESS CONTRACTORS"

FEBRUARY 9, 2012

Thank you Chairman Mulvaney, Ranking Member Chu and members of the Subcommittee. I am pleased to be testifying before you today on the topic of surety bonds.

The U.S. Small Business Administration (SBA) Surety Bond Guarantee program was established in 1971 to help small businesses obtain the surety bonds that are often required as a condition for award of a construction contract or subcontract. As you know, the Federal government requires a surety bond on any construction contract valued at \$150,000 dollars or more. Surety bonds are also required on many State, local government and commercial contracts and subcontracts.

In our surety bond program, SBA guarantees bid, performance and payment bonds for eligible small businesses that cannot obtain surety bonds through the conventional surety market. SBA's guarantee gives surety companies an incentive to provide bonding for small business contractors who they might otherwise perceive as too risky to bond without an SBA-guarantee. These bonds help small and emerging firms gain access to contracting opportunities in the commercial and government markets.

As many of you know, when the economic downturn occurred a few years ago, construction was one of the hardest hit sectors. In spite of the downturn, however, the SBA bond guarantee volume grew every year over the past five years. We also saw an increase in the number of participating surety companies and agents. When Congress passed the American Recovery and Reinvestment Act in February of 2009, SBA was given the authority to temporarily increase the surety bond contract ceiling to \$5 million dollars.

This change was well received by the surety industry and the small business community, and we noticed a significant uptick in bond volume. The Recovery Act infused new life into the surety bond program as seen by the increase in program activity in fiscal year 2010. The total number of bonds guaranteed in that year represented a 36% increase over the previous fiscal year. In fiscal year 2010, SBA guaranteed a total of 8,348 bonds representing a contract value contract value of \$4 billion dollars.

Building on that success, SBA has continued to make outreach and awareness of the surety bond program a priority. We have been working closely with our local district offices and industry partners to let small businesses know how they can take advantage of our program.

We have also been listening closely to our industry partners and small businesses on how we can make the program better and more accessible to a greater number of firms. Recently, we developed an automated tool to complement the electronic bond guarantee application, which we implemented a few years ago. Surety companies, agents, and small businesses, can now upload a variety of underwriting documents and transmit them electronically to our field offices. This helps make the processing time faster and reduces compliance costs.

This week, we will be publishing a proposed rule that will adopt a streamlined application process for any bond guarantee on a contract valued up to \$250,000. This new "Quick Application" process will reduce paperwork requirements for smaller contracts. As a result, small businesses and surety agents will navigate the bond application process more easily and the cycle time between application and approval will be compressed.

But we are not stopping there. In addition, like every other agency in the Administration, SBA has been tasked with undertaking a full review of our current regulations. In response to industry concerns that certain requirements imposed on surety companies are no longer consistent with industry best practices, our office is trying to update, streamline, and simplify the surety bond regulations.

We look forward to working closely with you and your staff on each of those initiatives. I appreciate the opportunity to testify before you today and I welcome any questions.

Thank you.

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U.S. ARMY CORPS OF ENGINEERS

DEPARTMENT OF THE ARMY

TESTIMONY OF

**JAMES C. DALTON, P.E.
CHIEF, ENGINEERING AND CONSTRUCTION
U.S. ARMY CORPS OF ENGINEERS
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**

February 9, 2012

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-side 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.



U.S. General Services Administration

William Guerin
Public Buildings Service
Assistant Commissioner
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Committee on Small Business
Subcommittee on Contracting and Workforce
February 9, 2012

Good morning Chairman Mulvaney, Ranking Member Chu, and members of the Subcommittee. My name is Bill Guerin, and I am the Assistant Commissioner for the Office of Construction Programs at the U.S. General Services Administration's (GSA) Public Buildings Service (PBS). Thank you for this opportunity to appear before you today to discuss how we pursue construction projects, the challenges and opportunities that exist within this process for small businesses, and our successes in meeting our small business goals.

GSA recognizes and values the importance small businesses play in our ability to help agencies meet their needs. We know that small businesses help drive our national economy and bring new and innovative solutions to Government challenges, which is why we strive to include small businesses in our acquisitions. In FY 2011, GSA awarded 41 percent of all contract dollars to small businesses.

Within GSA, PBS is primarily responsible for the Federal Government's civilian real property inventory. While we provide a variety of services for other Federal agencies, I want to focus today on PBS's new construction and repair and alterations projects within our owned inventory. Last year alone, PBS obligated more than one billion dollars to small businesses. We understand that a strong and successful small business community is integral to job creation, community empowerment, and economic revitalization for our nation.

How PBS Pursues Federal Construction

As with any major real estate organization, public or private, PBS pursues a robust asset management program that strives to make the proper investments in our inventory to maintain a portfolio of sustainable and well-performing assets to meet the long-term needs of Federal agencies.

The investments we make in our public buildings help to stimulate and retain job growth in the construction and real estate sectors, reduce energy consumption, improve the environmental performance of our inventory, reduce our backlog of repairs and alterations, and increase the value of our assets.

With appropriations, PBS has requested, on average, \$682 million in constructing new facilities over the last five years. Over this same time period, PBS has requested on average \$713 million for reinvestment to maintain our inventory of over 1,500 owned buildings, which have an average age of 47 years. Approximately 52 percent of these reinvestment dollars fund major modernization projects, while the remaining 48 percent fund the necessary minor repair and alterations needed to perform interior fit-outs to keep

our vacancy rates at an enviable low level, maintain the health and safety of building occupants, and provide the funds necessary to deal with minor emergencies and other needs that arise in the day-to-day operations of GSA's building inventory.

Procuring Construction Services

As real estate experts, PBS procures construction goods and services at the best value for the Government on behalf of the American taxpayer. PBS uses proven selection procedures that enable us to award contracts to deserving competitors who can offer the Government the best overall value.

GSA separately evaluates both the technical qualifications and the price of each proposal we receive. The merit of a technical proposal is reviewed on a variety of factors, including past performance and price, technical excellence, personnel qualifications, and experience with similar projects. On large construction projects that exceed \$1.5 million, GSA must evaluate a small business subcontracting plan in relation to the small business goals set for the project in the solicitation. These goals usually reflect GSA's small business goals for the fiscal year. This project plan represents a good faith commitment on the part of the contractor to ensure that small and disadvantaged subcontractors participate in the construction of every GSA project.

Small Business Opportunities within GSA

GSA understands the value of small businesses to our economy, and advocates for the participation of small businesses¹, including small disadvantaged, women-owned, HUBZone, veteran, and service-disabled veteran-owned small businesses, in its procurement process at both the prime and subcontracting levels.

GSA has aggressive goals for small business participation in our acquisitions. These goals are based on our forecast of requirements and associated contracting actions for the next fiscal year. GSA's small business contracting goal for FY 2011 was 27 percent of all contract dollars obligated. In FY 2011, GSA awarded 41 percent of all contract dollars to small businesses. PBS obligated more than \$1.05 billion, or approximately 39 percent of eligible dollars, to small businesses.

¹ The small business size standard for General Construction is \$33.5 million average annual gross receipts over the last three years. For Specialty Trade Contractors the size standard is \$14 million average annual gross receipts. If a procurement is set-aside for small business then the prime contractor must perform at least 15 percent of the cost of the contract, not including the cost of materials, with its own employees for general construction and at least 25 percent of the cost of the contract, not including the cost of materials, with its own employees for specialty trade contracts.

PBS's prime contractors continue this high level of small business participation in their subcontracting awards. In FY 2011, PBS contractors awarded more than 46 percent of all subcontracted dollars to small businesses.²

There are two main ways in which GSA provides small business opportunities in our construction projects: small business set-asides for prime contractors on our minor repair and alteration projects and smaller capital program projects, and as subcontractors on our major modernization and new construction projects.

Minor Repair and Construction Projects - In FY 2011, the majority of PBS's construction contracting opportunities were awarded from our minor repair and alteration funding. GSA historically requests, on average, \$340 million for minor repairs to maintain our buildings and take care of emergency work that arises during day-to-day operations. These minor repair projects total less than \$2.79 million and, for that reason, provide a perfect venue for small businesses.

For example, W.P. Mahon, a woman-owned, section 8(a) general contracting and roofing firm based out of Delaware, helped PBS replace and make significant roof repairs on the historic Mitchell H. Cohen U.S. Courthouse and Post Office in Camden, New Jersey. This project was a success due to Mahon's dedication and ability to work through inclement weather, without disrupting the tenants occupying the building. Mahon showed tremendous flexibility in expertly installing vacuum-insulated panels even though they had no prior experience with these products. This is a prime example of the types of projects we are privileged to award to small businesses.

Another one of PBS's small business success stories involves a small firm from Erlanger, Kentucky. This firm, Century Construction, installed 300 security bollards at the historic Gene Snyder Federal U.S. Courthouse in Louisville. The project completed by Century helped resolve a four-year old building security deficiency on this complex project. Century Construction finished on-schedule and on-budget without any disruptions to building operations.

Major Construction and Modernization Projects - Small businesses also have many opportunities to work on large GSA modernization and new construction projects, primarily as subcontractors.

Typically, small businesses may have difficulty obtaining prime contract awards in major construction as a result of bonding limitations. The Small Business Administration, however, assists by providing bonding assistance through their Surety Bond Guarantee

² Based on preliminary reporting through the Electronic Subcontracting Reporting System (eSRS); percentages are subject to change with final reporting.

Program for individual contracts of \$2 million or less for small and emerging contractors who cannot obtain surety bonds through regular commercial channels.

GSA strives to provide small businesses with prime contracting opportunities when possible. For example, PBS structured a \$46 million Recovery Act project in St. Louis, Missouri at the Robert A. Young Federal Building for small business. GSA established three separate construction projects and awarded the design to a small business architect-engineering firm who designed each project to ensure coordination and consistency. PBS awarded each of the three smaller projects to small businesses, which could not have competed for a single, larger project due to its size.

PBS's prime contractors on our large projects exceeding \$1.5 million must have small business plans and goals for these projects that are evaluated during the contract selection process. On these construction projects, we must evaluate a small business subcontracting plan in relation to the small business goals set for the project in the solicitation.

The relationships between our prime contractors and small business subcontractors are working successfully at GSA. For example, a number of small businesses are assisting us at the Department of Homeland Security campus at St. Elizabeths in Washington, DC, the largest construction project since the Pentagon. Small businesses consist of approximately 42 percent of the dollar value of all contracts at St. Elizabeths. Approximately 10 percent of those small businesses are 8(a) firms. These small businesses provide their expertise in more than 16 different types of work and field expertise.

To further our achievements in subcontracting, GSA has a Mentor-Protégé Program to assist our prime contractors in selecting small businesses in various fields, as well as helping to enhance small businesses' performance capabilities. This program allows smaller firms to team with our larger construction contractors to gain more direct experience in the construction field and make the transition to larger projects and contracts. We have more than 100 active agreements in place and expect even more in coming months. Protégé participants have reported 41 new contracts won as a result of assistance received from Mentor firms, with a total value amounting to nearly \$260 million. Additionally, we have seen an increase in subcontract awards to Protégés, which have reported 54 new subcontracts from Mentor firms.

To increase the availability of information, GSA publicizes prime contractor contact information online and hosts partnering events that enable small businesses to present qualifications and develop relationships with our prime contractors.

Small Business Challenges

We realize the importance and value small businesses bring to our agency and economy, and we track our large contracts to ensure our partners are meeting the commitments they made to GSA in their small business subcontracting plans. On major modernizations and new construction projects, our prime construction contractors directly issue subcontracts to other firms. As is common in construction, GSA's projects often involve many layers of subcontracting. These first-tier subcontractors issue further subcontracts to small businesses. The subcontracting plan clause requires that large business subcontracts that exceed \$1.5 million include the same subcontracting requirements as the prime contractor. But we do not have the opportunity to similarly track compliance with second- and third-tier contracts, creating a challenge in ensuring the actual dollars awarded to small businesses are accurately reflected.

Additionally, in the current budgetary environment, GSA has received very limited funds for large new construction and modernization projects. Indeed, in FY 2012, all of our repair and alteration funding will be used for minor projects, rather than major modernizations. Most of the contract opportunities, as mentioned previously, will be ideal for small businesses.

Conclusion

I am happy to be here today to discuss the success GSA has had in encouraging small business participation on our construction projects, both on the prime contract level and in subcontracting. While there are challenges in the current system, GSA has developed and will continue to develop new and innovative ways to promote small business participation in our construction projects, helping strengthen small business communities and foster partnerships both with GSA and with the broader construction community.

Thank you for the opportunity to appear before you today and I welcome any questions you or other members of this Subcommittee have for me.



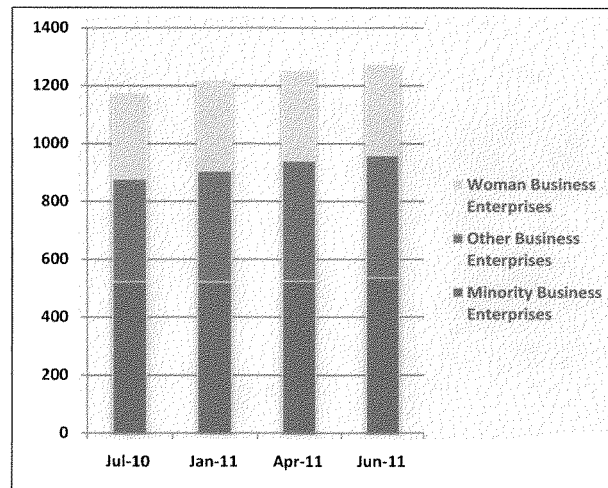
San Francisco Human Rights Commission

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San Francisco Administrative Code Chapter 14B
Local Business Enterprise and Non-Discrimination in
Contracting Ordinance
Summary of Findings
Third Quarter FY 2010/11

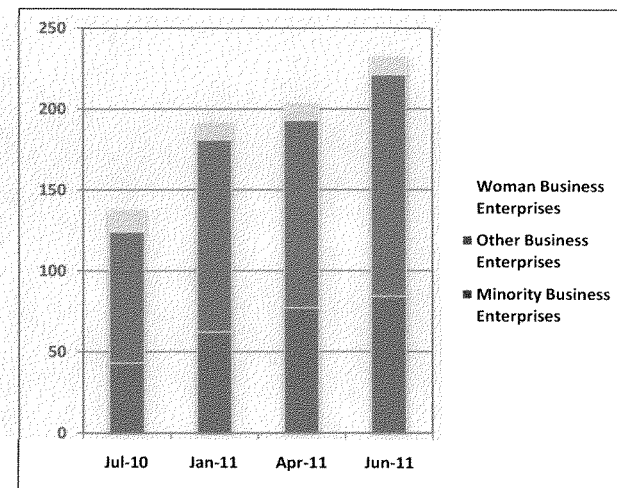
SF LBE and SFPUC Certified Firms by M/W/OBE Category

Certified LBE Firms



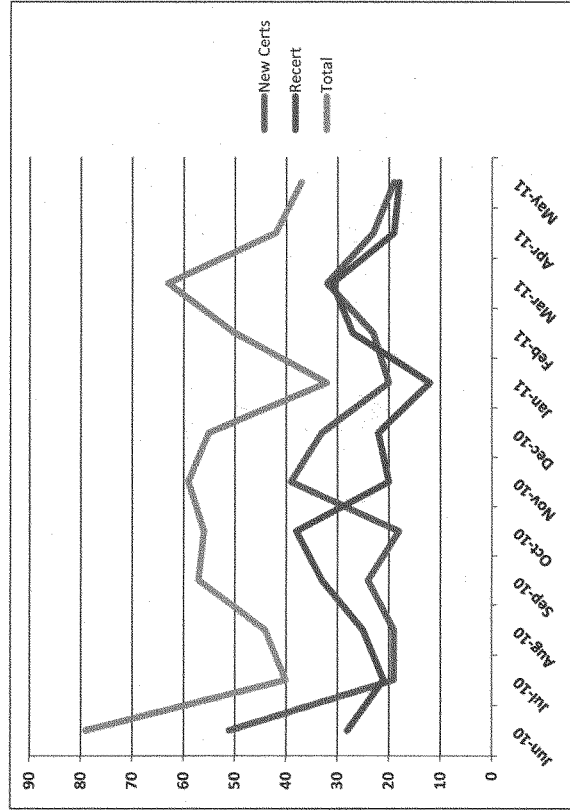
SF LBE Certified Firms	Jul-10	Jan-11	Apr-11	Jun-11
Minority Business Enterprises	522	521	524	535
Other Business Enterprises	355	384	416	424
Woman Business Enterprises	298	314	314	316
Total	1175	1219	1254	1275

SFPUC Certified LBE Firms



SFPUC LBE Certified Firms	Jul-10	Jan-11	Apr-11	Jun-11
Minority Business Enterprises	43	62	77	84
Other Business Enterprises	81	119	116	137
Woman Business Enterprises	14	11	11	12
Total	138	192	204	233

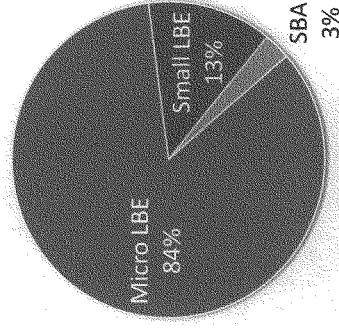
Monthly Certification and Recertifications Previous 12 Months (614 Firms)



Note: Currently, the HRC certifies an average of 51 total firms per month.

Comparison of Size Standard Thresholds for Local Business Enterprises and Small Business Administration Firms

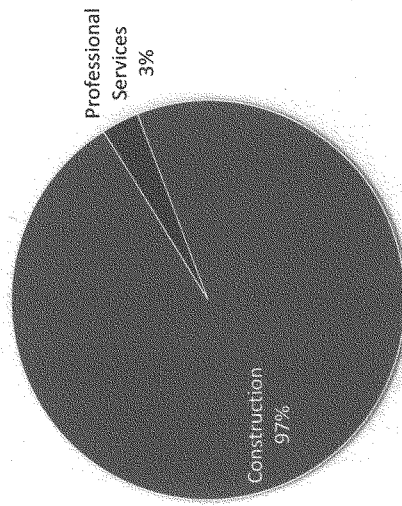
Industry	Certification Size Standards (Average Gross Receipts)		
	For San Francisco "Micro Business" LBE, PUC-LBE	For San Francisco "Small Business" LBE, PUC-LBE	San Francisco SBA Program
General Construction Contractors (A and B Class)	\$7M	\$14M	\$33.5M
Subcontractors (C License)	\$3.5M	\$7M	\$14M
Professional Services	\$1.25M	\$2.5M	\$4.5-\$8M
Architects	\$1.25M	\$2.5M	\$4.5M
Engineers	\$1.25M	\$2.5M	\$7M
Goods, Materials Suppliers, General Services	\$3.5M	\$7M	\$17M
Trucking	1.75M	\$3.5M	\$25.5M



LBE Size	Count
Micro LBE	1310
Small LBE	200
SBA	45

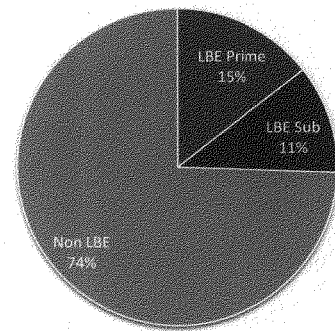
- 84% of all certified San Francisco LBEs are "Micro Business" LBEs

14B Contract Award Dollars by Industry
 3rd Quarter FY 2010/11
 (8 Contracts - \$221.3 M)



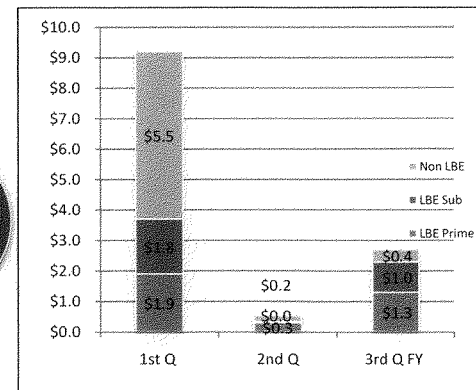
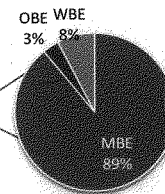
	1st Q	2nd Q	3rd Q
Construction	\$ 42,228,151	\$ 169,165,298	\$ 214,496,589
Professional Services	\$ 13,804,720	\$ 32,015,000	\$ 6,822,733
Total	\$ 56,032,871	\$ 201,180,298	\$ 221,319,322

Airport Contracts 3rd Quarter FY 2010/11 (5 Contracts - \$9 M)



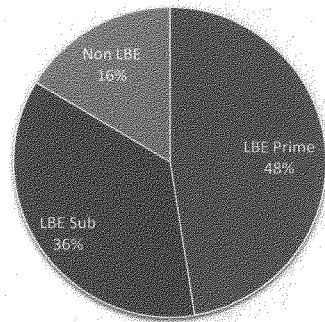
- LBE prime contractor on 3 (or 60%) of 5 awarded contracts
- 3 construction and 2 professional service contracts
- 1 micro set-aside contract awarded
- 1 contract with waived goals

	1st Q FY 10/11	2nd Q FY 10/11	3rd Q FY 10/11
LBE Prime	\$1,924,162	\$314,200	\$ 1,305,530
LBE Sub	\$1,839,866	\$32,000	\$ 992,395
Non LBE	\$5,501,962	\$227,000	\$ 6,694,415
Total	\$9,265,990	\$573,200	\$ 8,992,340

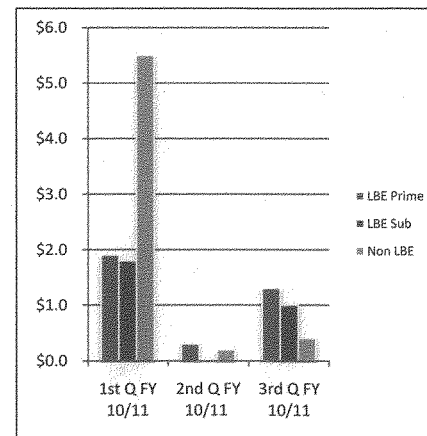
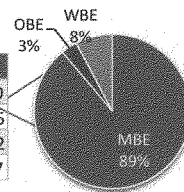


Airport
3rd Quarter FY 2010/11
(4 Contracts - \$2.7M)
No Waived Contracts

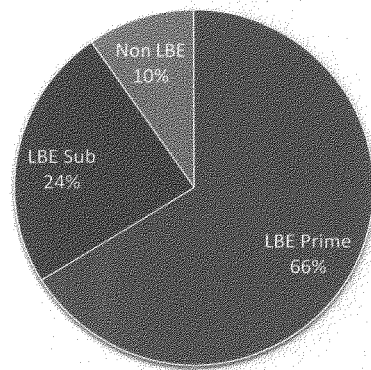
- LBE prime contractor on 3 (or 75%) of 4 awarded contracts
- 3 construction and 1 professional service contract
- 1 micro set-aside contract awarded



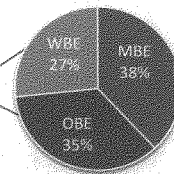
	1st Q FY 10/11	2nd Q FY 10/11	3rd Q FY 10/11
LBE Prime	\$1,924,162	\$314,200	\$ 1,305,530
LBE Sub	\$1,839,866	\$32,000	\$ 992,395
Non LBE	\$5,501,962	\$227,000	\$ 451,682
Total	\$9,265,990	\$573,200	\$ 2,749,607



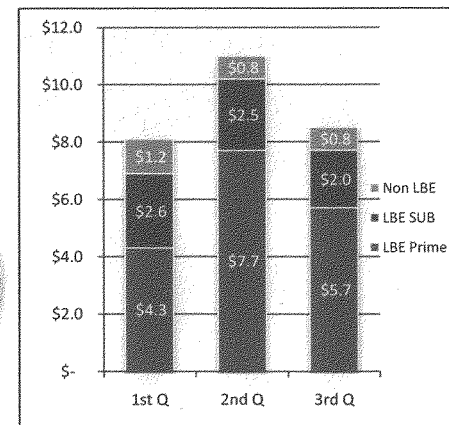
Department of Public Works
Contracts 3rd Quarter FY 2010/11
(8 Contracts - \$8.7 M)



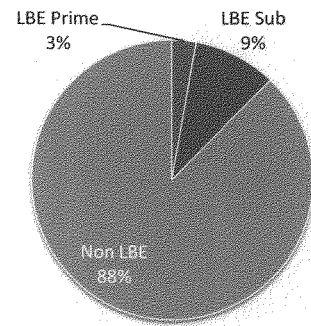
	1st Q	2nd Q	3rd Q
LBE Prime	\$ 4,378,110	\$ 7,689,620	\$ 5,737,369
LBE SUB	\$ 2,599,523	\$ 2,523,416	\$ 2,073,606
Non LBE	\$ 1,170,581	\$ 833,947	\$ 844,370
Total	\$ 8,148,214	\$ 11,046,983	\$ 8,655,345



- LBE prime contractor on 7 (or 88%) of 8 awarded contracts
- 8 construction contract
- 1 micro set-aside contract awarded
- 1 contract with waived goals
- Average LBE goal 25%
- 5 different LBE primes utilized on 8 contracts

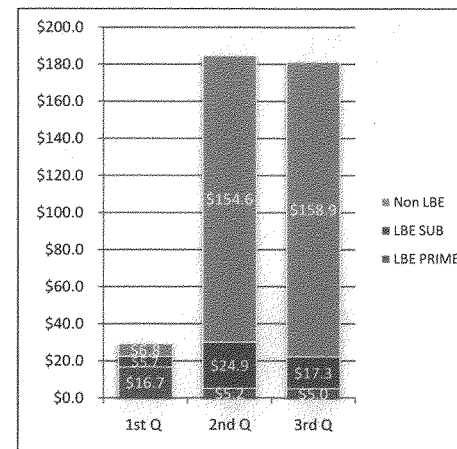
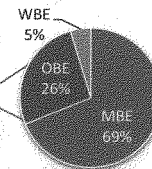


Public Utilities Commission
All Contracts 3rd Quarter FY 2010/11
(7 Contracts - \$181.2 M)



- LBEs are prime contractors on 5 (or 71%) of awarded contracts
- 5 different LBE prime contractors utilized
- 6 construction and 1 professional service contracts
- LBE utilization impacted by \$174M contract, HTWTP Long Term Improvements Projects

	1st Q FY 10/11	2nd Q FY 10/11	3rd Q FY 10/11
LBE PRIME	\$16,708,161	\$5,154,310	\$ 5,081,049
LBE SUB	\$5,708,639	\$24,859,776	\$ 17,307,289
Non LBE	\$6,803,473	\$154,627,097	\$ 158,898,970
Total	\$29,220,273	\$184,641,183	\$ 181,287,308

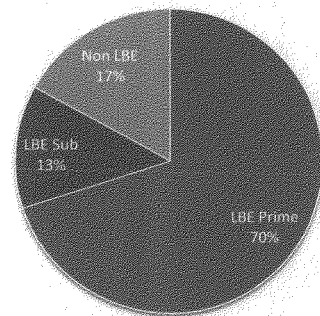


Public Utilities Commission

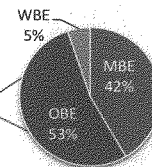
Contracts Under \$10M

3rd Quarter FY 2010/11

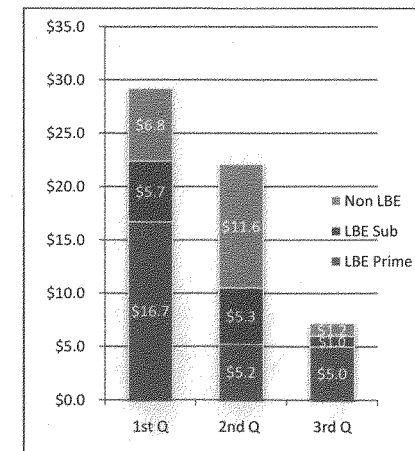
(6 Contracts - \$7.2 M)



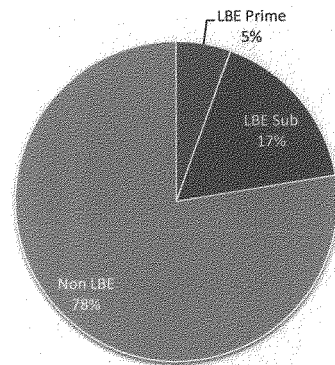
	1st Q FY 10/11	2nd Q FY 10/11	3rd Q FY 10/11
LBE Prime	\$1,924,162	\$314,200	\$ 1,305,530
LBE Sub	\$1,839,866	\$32,000	\$ 992,395
Non LBE	\$5,501,962	\$227,000	\$ 6,694,415
Total	\$9,265,990	\$573,200	\$ 8,992,340



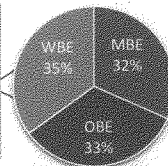
- Contracts over \$10M are not subject to a bid discount
- LBEs are prime contractors are 5 (or 83%) of contracts awarded under \$10M
- 15% is average LBE goal on contracts under \$10M
- 2 micro set aside contracts awarded



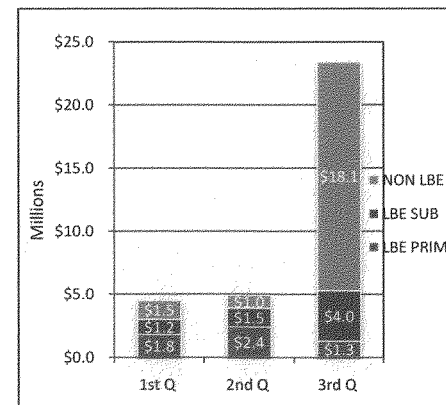
Recreation and Park Department Contracts 3rd Quarter FY 2010/11 (2 Contracts - \$23.3M)



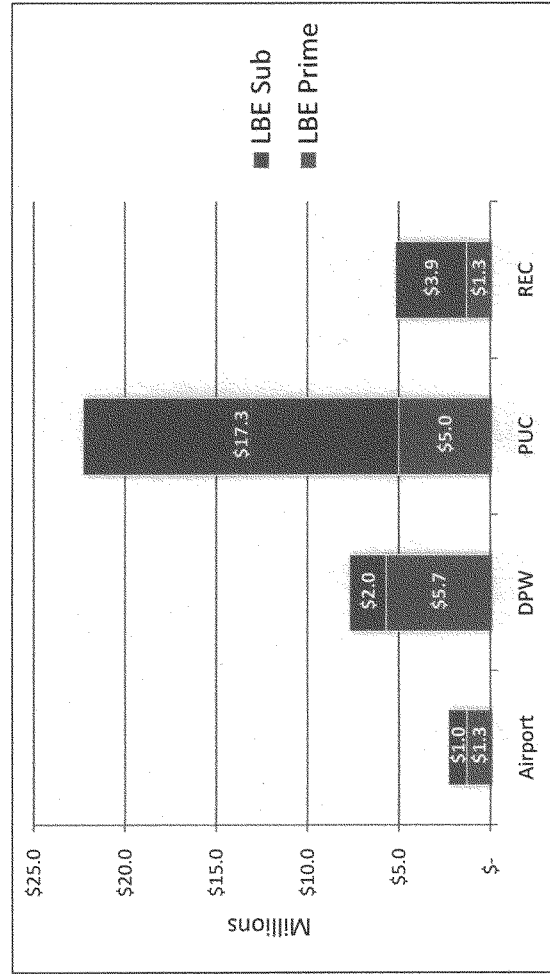
	1st Q FY 2010/11	2nd Q FY 2010/11	3rd Q FY 2010/11
LBE PRIME	\$1,779,660	\$2,417,478	\$1,286,982
LBE SUB	\$1,162,821	\$1,468,943	\$3,939,253
NON LBE	\$1,505,509	\$1,032,511	\$18,105,914
Total	\$4,447,990	\$4,918,932	\$23,332,149



- LBE prime contractor on 1 (or 50%) of awarded contracts
- 2 contracts awarded were Marina West Harbor Renovation and Mission Clubhouse & Playground Rebuild
- All contracts awarded were construction contracts
- Zero micro set-aside contracts
- Average LBE goal is 13%

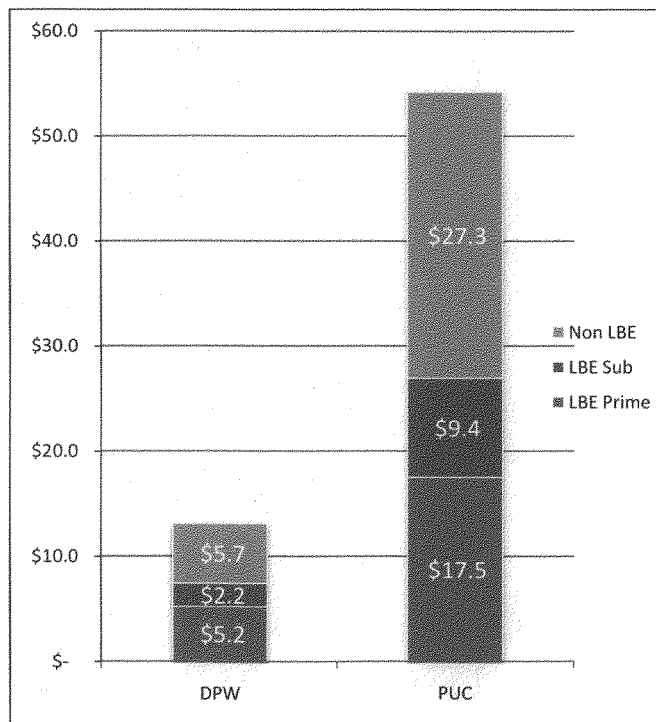


14B Contract Dollars Awarded to LBEs by Department 3rd Quarter FY 2010/11



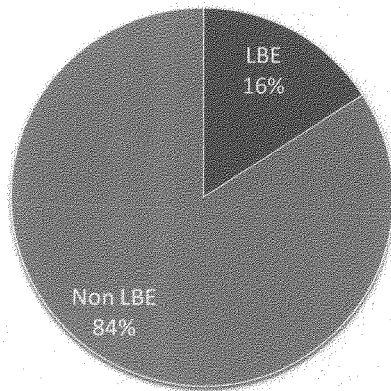
LBEs Awarded \$37.7 Million (17%) of the 14B Governed Contract \$

Job Order Contracts (2006 – Present)



- 31 PUC and 7 DPW active Job Order Contracts
- \$63.8 Million in task orders issued by the PUC and \$12.8 Million by DPW
- The average LBE subcontract participation goal set on JOC contracts is 13% at DPW and 15% at PUC
- DPW has issued 2 micro set aside JOC contracts
- LBEs are primes on 12 (or 39%) of PUC and 4 (57%) of DPW JOC contracts
- LBEs received 56% of DPW and 50% of PUC dollars awarded through JOCs

Proposition Q Procurement
3rd Quarter FY 2010/11
(6,824 Transactions - \$10.4M)



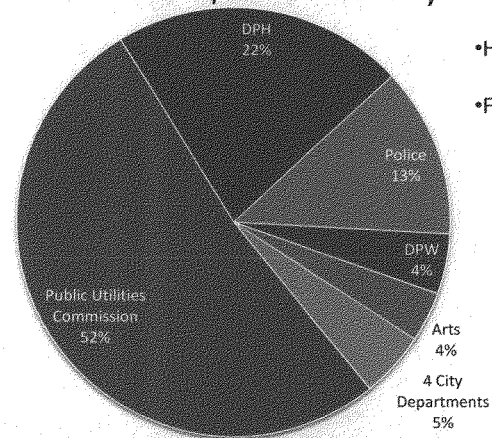
	1st Q	2nd Q	3rd Q
LBE	\$ 2.1 M	\$1.7 M	\$ 1.7 M
Non LBE	\$ 11.1 M	\$8.2 M	\$ 8.7 M
Total	\$ 13.2 M	\$9.9 M	\$ 10.4 M

- Prop Q purchases are acquisitions for goods and services under \$10,000
- Prop Q purchases from LBEs remained at 13% from FY 2008/09 to 2009/10
- Prop Q purchases from LBEs remain at 16% for the first three quarters of FY 2010/11
- Top 5 procurement categories

• Common Diesel Parts	\$455K
• Light Rail Vehicle Equip	\$424K
• Laboratory Services	\$421K
• Electric Vehicle Parts	\$366K
• Labor Charges	\$233K
- Top 5 Prop Q purchasing departments

• PUC	\$1.6M (10% LBE)
• MTA	\$1.3M (21% LBE)
• DPH	\$871K (14% LBE)
• DPW	\$485K (28% LBE)
• AIR	\$325K (11% LBE)

Chapter 14B Waivers
2nd Quarter FY 2010/11
(28 Waivers - \$13.2 Million)



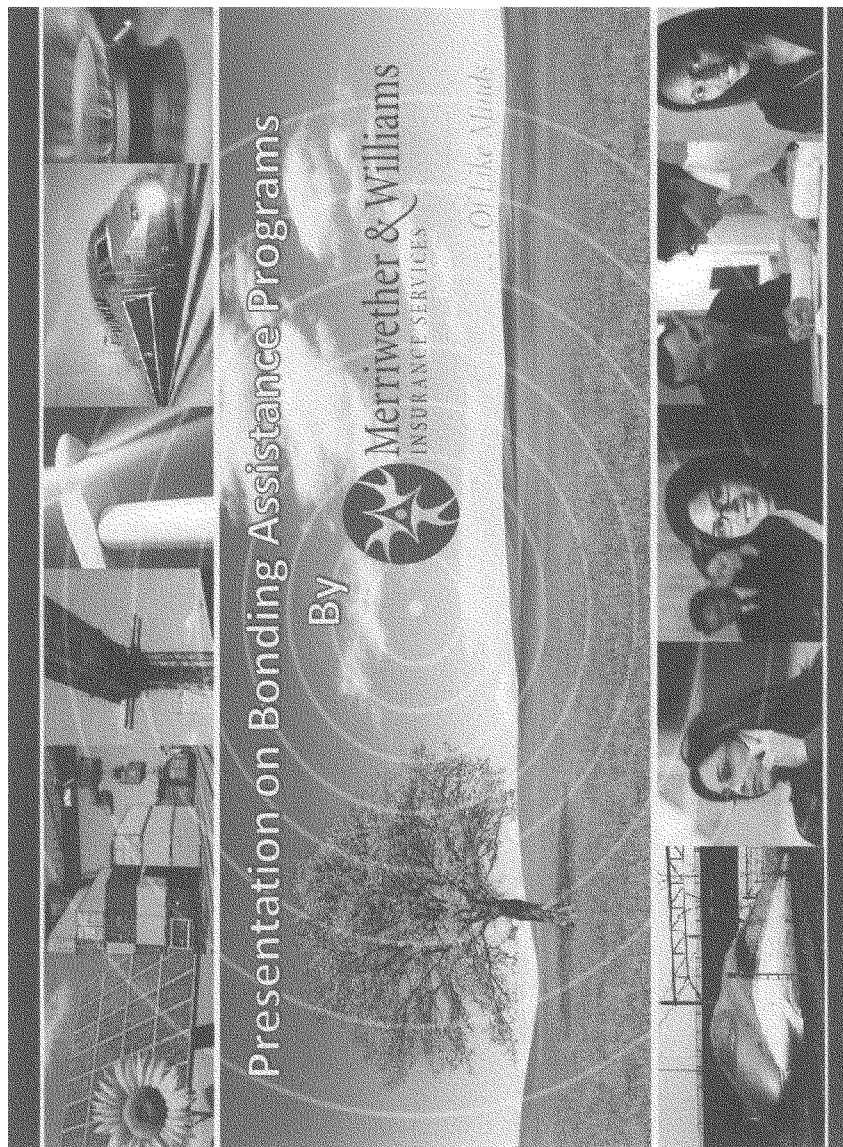
Department	Contract Amount
Public Utilities Commission	\$ 6,884,572
DPH	\$ 2,905,000
Police	\$ 1,696,821
DPW	\$ 600,000
Arts	\$ 500,000
4 City Departments	\$ 657,620
Total	\$ 13,244,013

•HRC received 29 Chapter 14B waiver requests, 28 were approved

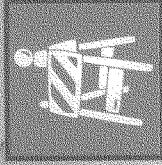
•Five largest request:

•Port	\$14.M	Subcontracting Goal(Denied)
•PUC	\$3.0M	Subcontracting Goal
•PUC	\$2.0M	Sole Source
•SFPD	\$1.5M	Subcontracting Goal
•PUC	\$1.2M	Sole Source

Waiver Type	Amount
Sole Source	\$ 7,165,259
Subcontracting Goal	\$ 6,012,636



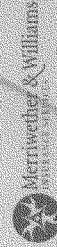
The Bonding/Capacity Barrier

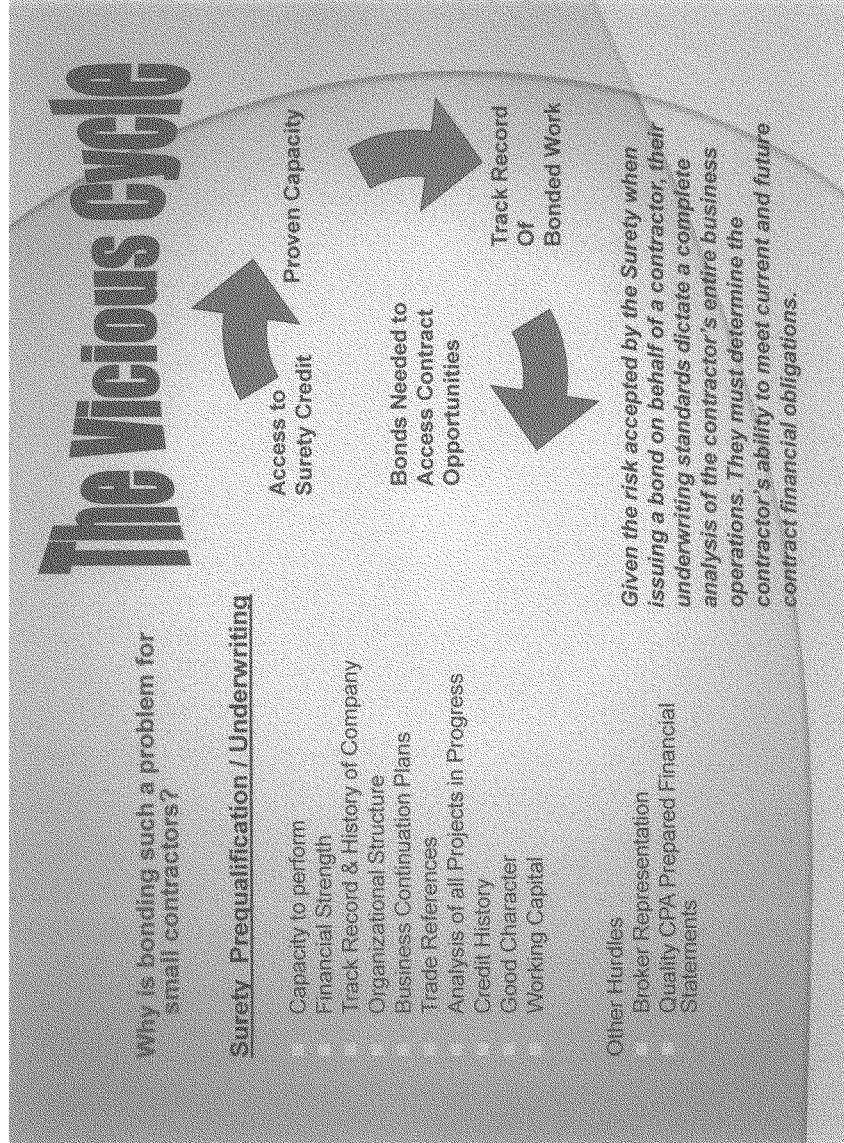


- Lack of access to bonding by Small, Minority, Women and Disabled Veteran Owned Contractors has precluded their equitable participation in public contracting and diminishes their ability to grow capacity.
- Not only has this stymied their growth, the multiplicative impact has prevented more diverse distribution of public dollars.
- The fewer bonded contractors in the contracting pool results in suppressed competition, and increased contracting costs to public agencies.

Contractor Bonding, Financing & Technical Assistance Programs

- These programs have enabled contractors to bid on \$546.7M in contracts with program sponsors, and program contractors were awarded \$169.7M in contracts. The programs have saved their sponsors \$11.1M in contract cost savings resulting from “low bid spread” between program contractors enabled to bid and second low bidders. Our program loss ratio of .2% by far out performs the industry loss ratio.





How Does A Bonding & Financing Assistance Program Help?

- Better Prepare Contractor for Bond Underwriting
 - Consultative Services
 - Contractor Assessments (Pre-Qualify) / Capacity Building
 - Referrals to qualified resources, broker, bank, CPA
 - Assistance/Subsidy towards CPA Prepared Financial Statements
 - Facilitate Collateral Support and/or Funds Administration as Needed
- Program partners
 - Brokers, Sureties, Lenders Funds Administrators, CPA's experienced in servicing small contractors
- Mitigate exposure to the Surety/Finance Company
 - Bond & Loan Guarantees
 - Third Party Funds Administration
 - Contract Monitoring
 - Pre-Claim / Default Problem Resolution

The Bonding & Financing Assistance Program Benefits:

Sponsor Benefits

- Expand existing pool of bondable contractors, increasing competition, reducing costs
- Enhance distribution of public spending to more diverse communities
- Coincides with targeted outreach with quantifiable results
- Help to obtain Small/Minority/Women/DBE and Disabled Veteran's business participation and build long-term local contractor capacity



Contractor Benefits

- Establish their first bond or increase current capacity
- Enhance their ability to bid all public works projects
- Grow their business
- Larger prime contractors can reduce their risk by having small contractors "bond back"

\$750,000 to \$2.6 Million – Largest Contract in 3 Years!

— San Francisco Redevelopment Agency Fillmore Heritage Project

Contractor Bonding, Financing & Technical Assistance Programs

These programs are seen as a complement to entities who strive for greater distribution of contracting dollars into the communities they serve and have a multiplicative impact on creating more local resident hiring particularly from diverse communities.

• Program Services

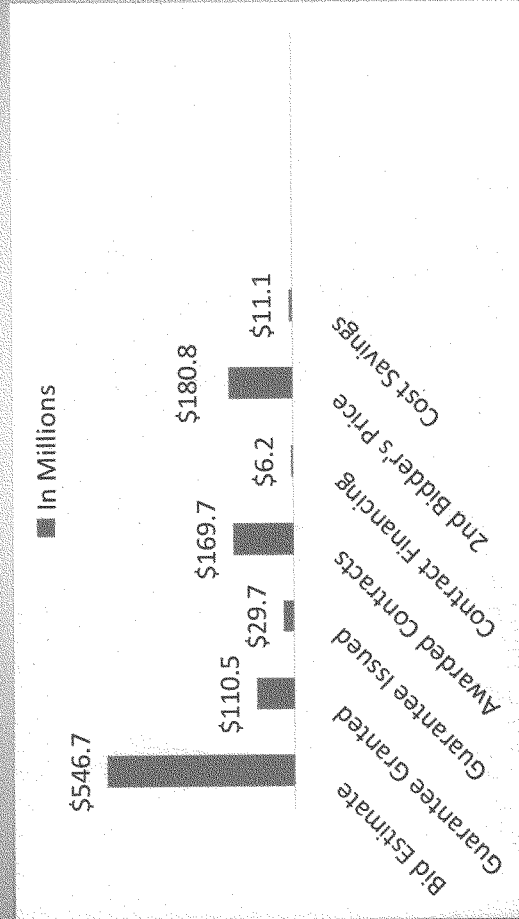
- Contractor Outreach / Assessments / Capacity Building
- Contractor Consultation / Technical Assistance
- Bond / Contract Financing Guarantee Underwriting
- Third Party Funds Administration
- Post Award Contract Monitoring and Support
- Workshops / Seminars

Contractor Bonding, Financing & Technical Assistance Programs

These programs are seen as a complement to entities who strive for greater distribution of contracting dollars into the communities they serve and have a multiplicative impact on creating more local resident hiring particularly from diverse communities.

- Program has received recognition and awards from:
 - "Med Week" – Award for Finance Programs – 2006, 2007
 - National Association of Minority Contractors Advocate Award 2005
 - Business to Business "Service of the Year" – 2004
 - San Francisco Business Times – Women in Leadership Award 2000
 - City of Los Angeles Department of Public Works Commendation – 2008
 - Inner City 100 National Award- 2011

BOND / CONTRACT FINANCING GUARANTEE LEVERAGING AND CONTRACT SAVINGS

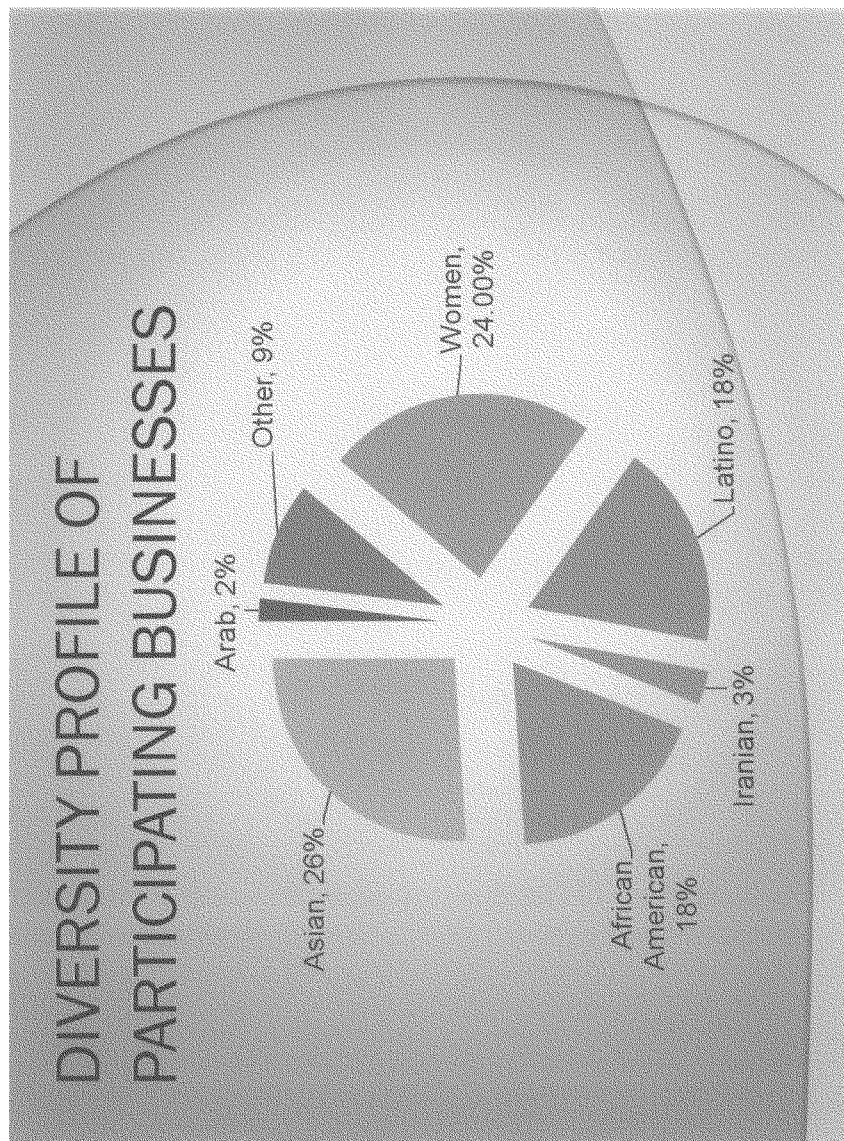


BOND GUARANTEE REPORT
As of June 30, 2011

Construction Firm	Date of Request	Bid Estimate	Guarantee Requested	Bid Results	Final Contract Bond Amt	Guarantee Issued	Capturing the Savings from Program Services As of June 30, 2010		
							Awarded Contract Price	2nd Bidders Price	Difference
MH Construction	06/23/11	1,650,000.00	240,000.00	Pending					
MH Construction	06/17/11	1,200,000.00	195,000.00	Not Low		N/A			
AA Pacific Builders	06/15/11	550,000.00	220,000.00	Pending					
Cogent Construction & Consulting, Inc.	06/16/11	510,000.00	264,000.00	Pending					
AEW Engineering	06/07/11	425,000.00	170,000.00	Did Not Bid					
MH Construction	06/26/11	1,750,000.00	300,000.00	Not Low		N/A			
Cogent Construction & Consulting, Inc.	06/17/11	1,800,000.00	295,000.00	Not Low		N/A			
AEW Engineering	05/13/11	400,000.00	176,000.00	Did Not Bid		N/A			
AEW Engineering	05/12/11	500,000.00	130,000.00	Did Not Bid		N/A			
Bay Area Lightworks	05/10/11	1,300,000.00	132,000.00	Low	Pending Award in June				
MH Construction	05/10/11	2,700,000.00	290,000.00	Not Low		N/A			
Penique Construction	04/21/11	400,000.00	80,000.00	Did Not Bid		N/A			
Knobler Associates	04/07/11	280,000.00	29,000.00	Low					
Oliver Transbay	03/31/11	600,000.00	120,000.00	Not Low		N/A			
Bay Area Lightworks	03/17/11	1,600,000.00	279,000.00	Low	1,062,880.00	159,422	1,062,880.00	1,485,880.00	423,010.00
MH Construction	02/14/11	2,300,000.00	343,000.00	Not Low		N/A			
AEW Engineering	01/19/11	200,000.00	80,000.00	Low		N/A			
MH Construction	01/18/11	1,900,000.00	270,000.00	Not Low		N/A			
Bay Area Lightworks	12/16/10	2,150,000.00	332,500.00	Not Low		N/A			
Oliver Transbay	11/23/10	1,300,000.00	300,000.00	Not Low		N/A			
Rubecon General Contracting	11/22/10	1,000,000.00	400,000.00	Not Low		N/A			
Oliver Transbay	10/11/10	350,000.00	70,000.00	Not Low		N/A			
Oliver Transbay	10/11/10	750,000.00	150,000.00	Did Not Bid		N/A			
AA Pacific Builders	05/25/10	150,000.00	30,000.00	Low	121,600.00	30,000.00	121,600.00	122,600.00	1,000.00
MH Construction	05/17/10	3,300,000.00	360,000.00	Not Low		N/A			
Emmet Engineering Construction	03/10/10	150,000.00	30,000.00	Not Low		N/A			
Rubecon General Contracting	01/20/10	14,956,597.83	750,000.00	Negotiated	14,056,597.83	750,000.00			
Goodley Pacific Drilling	01/20/10	1,300,000.00	750,000.00	Low	1,471,000.00	\$88,468.00	1,471,000.00	1,695,000.00	224,000.00
Pact Construction Management	12/30/09	360,000.00	22,000.00	Low	362,600.00	54,000.00	362,600.00	464,548.00	41,948.00
Reas Construction & Electric	10/29/09	28,000.00	20,000.00	Not Low		N/A			
Oliver Transbay Constr.	10/19/09	500,000.00	100,000.00	Not Low		N/A			
Bay Area Lightworks	10/12/09	1,250,000.00	125,000.00	Low	928,806.00	92,881.00	928,806.00	1,013,240.00	84,434.00
RPE Construction	10/07/09	1,500,000.00	520,000.00	Not Low		N/A			
AEW Engineering	08/26/09	200,000.00	80,000.00	Negotiated	200,000.00	80,000.00			
Ward of Metals	06/24/09	926,000.00	370,000.00	Negotiated	926,000.00	370,000.00			
AEW Engineering	12/01/08	200,000.00	80,000.00	Negotiated	200,000.00	80,000.00			
Phoenix Electric Company	10/15/08	975,000.00	195,000.00	Low	1,073,888.00	195,000.00	1,073,888.00	1,186,000.00	112,112.00
Oliver Transbay Constr.	09/17/08	500,000.00	200,000.00	Did Not Bid		N/A			
Remediation Services	09/05/08	592,528.00	173,018.00	Negotiated		N/A			
Synergy Project Management	04/16/08	1,786,933.00	750,000.00	Not Low		N/A			
Phoenix Electric Company	01/09/08	1,590,000.00	300,000.00	Low	1,283,449.00	256,770.00	1,283,449.00	1,757,344.00	473,495.00

Risk Management

- Program Management by Surety/Finance Professionals
- Third Party Funds Administration
- Status Updates / Two-Way Communication / Pre-Claim Mitigation
- Collateral Management / Transaction Closeout
- Indemnity Agreements





Structure / Considerations

Current programs in place are centralized with a single source host sponsor. This helps to ensure access to the resource for all project contract opportunities and better enables contractor bonding/capacity management. A Design/Build or Prime Contractor hosted program will necessitate program structure, access and delivery considerations.

- How will project-wide access be attained
- Consistent Approach/Method to bonding/capacity assistance will translate to ease of use and functionality for small/DBE contractors
- Sourcing Program Collateral Pool
- Maximize Economies of Scale Program Cost Savings

Cost Considerations

- Programs Guarantee Pool- Contingent Liability
 - Leverage Collateral Dollars
 - Funded vs. Unfunded
 - Guarantee Cap Threshold
 - Guarantee Host
- Third Party Fees
 - Bank Letter of Credit Fees
 - Funds Administration- 1%
- Economies of Scale Cost Benefit
 - Contractor Outreach to include bonding/technical assistance/assessments/capacity building
 - Shared Resources

Bonding & Financing Assistance Programs

- San Francisco International Airport
- City and County of San Francisco
- Los Angeles Community College District
- City of Los Angeles (multi-agency program)
- Port of Oakland
- Los Angeles Unified School District
- San Diego Regional Airport Authority
- Alameda County

Telephone (202) 874-6850

February 3, 2006

**SPECIAL INFORMATIONAL NOTICE TO ALL BOND-APPROVING
(CONTRACTING) OFFICERS**

Important Information Regarding the Use of Individual Sureties on Federal Bonds

Subchapter E, Part 28 of the Federal Acquisition Regulation (FAR) provides guidance as to the acceptability of sureties and other security for Federal bonds. Acceptable security on Federal bonds include, but are not limited to, both corporate and individual sureties. FAR § 28.201. Acceptable corporate sureties must appear on the Department of Treasury's Circular 570. Treasury's Financial Management Service, Surety Bond Branch (FMS), publishes Department Circular 570 in the Federal Register.

Contracting officers determine the acceptability of individual sureties and ensure that the individual surety's pledged assets are sufficient to cover the bond obligation in accordance with the guidance outlined in the FAR § 28.203.

Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where **individual sureties are listing corporate debenture notes and other questionable assets on their "Affidavit of Individual Surety"**, Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit. **FAR § 28.203(b) specifically requires the use of the Standard Form 28.** In addition, FAR § 28.203-2(a) states that **"the Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations."**

FAR § 28.203-2(b) includes **examples of acceptable assets**, such as:

- cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution
- United State Government securities
- stocks and bonds actively traded on a national U.S. security exchange
- real property owned fee simple by the surety subject to certain conditions (refer to FAR 28.203-2(b)(4))
- irrevocable letters of credit issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number.

Furthermore, FAR § 28.203-2(c) lists **unacceptable assets**, but indicates that the list is not all-inclusive. The following are listed as unacceptable assets:

- notes or account receivable
- foreign securities

- real property located outside the United States, its territories or possessions
- real property used as the principal residence of the surety
- real property owned concurrently
- life estates, leasehold estates, or future interest in real property
- personal property except as listed in FAR 28.203-2(b)
- stocks and bonds of the individual surety in a controlled, affiliated or closely held concern of the offeror/contractor
- corporate assets
- speculative assets
- letters of credit except as provided in FAR 28.203(b)(5)

The FAR also requires that the Government be given a security interest in any acceptable assets pledged by an individual surety. FAR § 28.203-1(a).

Prior to acceptance of an individual surety, FAR guidelines require contracting officers to obtain the opinion of their legal counsel as to the adequacy of the documentation pledging assets. FAR § 28.203(f).

If you have any questions, please feel free to contact this office at the above number.

Sincerely,

/Signed/ Rose Miller

Rose Miller
Manager
Surety Bond Branch



SHEET METAL AND AIR CONDITIONING CONTRACTORS' NATIONAL ASSOCIATION

February 9, 2012

The Honorable Mick Mulvaney, Chair
 The Honorable Judy Chu, Ranking Member
 Subcommittee on Contracting and Workforce
 Committee on Small Business
 United States House of Representatives
 Washington, D.C. 20515

Re: Feb. 9 Hearing -- Construction Contracting: Barriers to Small Business Participation

Dear Chairman Mulvaney and Ranking Member Chu:

I am writing on behalf of the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA). SMACNA is supported by more than 4,500 construction firms supplying expertise in industrial, commercial, residential, architectural and specialty sheet metal and air conditioning construction throughout the United States. The majority of these contractors run small, family-owned businesses. We are grateful to the Committee for its willingness to examine and take action on public contracting matters affecting small businesses in such an unprecedented and comprehensive manner. Your efforts to enhance and facilitate the participation of small businesses in the federal marketplace are needed and welcome. Many of the proposed changes will strengthen the federal procurement process to the benefit of the government, the taxpayer and the small business contractor.

SMACNA represents a broad group of high skill specialty construction industry employers who perform federal construction work across the nation. Many perform as prime contractors but many of them contract as subcontractors on federal government projects. The comprehensive set of issues and recommendations that have been drawn up by the committee addresses many of the challenges faced by small businesses when bidding work for the federal government.

Proper and well thought-out reforms will attract a broader base of well-qualified small business contractors to compete for federal government contracts, increasing project performance and value for the federal government. SMACNA supports reforms that would enhance prompt and fair payment procedures and processes that would create reliable retainage policies. Reforms in these two areas would address significant barriers to small business owners that currently are wary of bidding on federal work and would increase the number and quality of small business contractors entering the federal marketplace.

We also believe the federal government should make the best use of federal dollars on construction at every level and that integrity and high business ethics are important. SMACNA takes a strong stance against fraud and supports fair application of suspension and debarment tools, including unfair representation of eligibility for small business contracting programs. SMACNA strongly advocated for and supported the 2008 enactment of the federal compliance database for contractor responsibility determinations in the Contractors and Federal Spending Accountability Act. Federal government dollars should go only to legally compliant and reliable contractors and any firm that misrepresents itself as a small employer should be held accountable.



CAPITOL HILL OFFICE: 305 4TH STREET NE • WASHINGTON DC 20002
 PHONE: 202 547 8202 • FAX: 202 547 8810
 HEADQUARTERS: 4201 LAFAYETTE CENTER DRIVE • CHANTILLY VA 20151-1209
 MAIL ADDRESS: P.O. BOX 221230 • CHANTILLY VA 20153-1230
 PHONE: 703 803 2980 • FAX: 703 803 3732
 WEB: www.smacna.org

Additionally, small businesses must have access to surety bonds to successfully compete in the federal marketplace. Surety bonds are a vital mechanism to protect taxpayers and workers on public construction projects from the danger of contractor default. Requiring individual sureties to pledge solely those assets described as "eligible obligations" and to deposit them in the custody and control of the federal government ensures the security of the bond obligation and helps the small business secure necessary bonding while still protecting the taxpayer dollar.

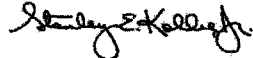
SMACNA is pleased the Subcommittee is considering the issue of in-sourcing. When contractors are involved in building or retrofitting high performance buildings to meet federal energy policy goals, the utmost consideration must be given to building operations and maintenance to achieve and sustain the highest level of energy savings. It is a function that should be contracted out to those with the greatest expertise and experience and in-sourcing this function should be open to notice and comment.

There is one major issue not addressed today that SMACNA feels must be attended to if the federal government is to get the best value for its construction contracting dollar. It is the practice of post-award bid shopping. We believe that low bid contractor selection procedures for federal construction projects of \$1 million or more should require that prime contractors list major subcontractors and require those subcontractors to be used except for clearly defined good cause. Post-award bid shopping and bid peddling is criticized by all yet it remains a pervasive practice. Many of the states represented by Members of this committee address the issue of bid-shopping and bid-peddling and the time has come for bid listing in federal contracting.

The federal government has moved to best-value negotiation selection procedures for some very good reasons, including performance and administrative problems with the low-bid system. It is, therefore, very important when the low-bid system is used for projects of appropriate scope that legitimate, competing small businesses do not face unfair barriers or unchecked practices. Agency projects and taxpayers would benefit by top quality reforms

In closing, SMANCA supports your efforts to strengthen procurement systems and procedures for small businesses participating in the federal marketplace and recognizes that the Small Business committee, in general, is to be commended for efforts it takes on behalf of small businesses across America on a bi-partisan basis in a climate that is sometimes sharply divided. We look forward to being a part of that process in this and other matters.

Respectfully,



Stanley E. Kolbe, Jr.
Director, Legislative Affairs
SMACNA's Capitol Hill Office



National Association of
Surety Bond Producers (NASBP)
1140 19th Street, NW, Suite 800
Washington, DC 20036



The Surety & Fidelity
Association of America (SFAA)
1101 Connecticut Ave. NW, Suite 800
Washington, DC 20036

H.R. 3534, the "Security in Bonding Act of 2011"

Dear Congressmen Hanna and Mulvaney:

On behalf of the national trade associations listed below, representing contractor and specialty contractor firms, bonding agencies, and surety and property/casualty insurers, operating throughout the United States, we support legislation to protect small businesses and taxpayer funds with the introduction of H.R. 3534, the "Security in Bonding Act of 2011."

Surety bonds on federal construction projects ensure that such projects will be completed, preserving public funds, and that subcontractors and suppliers, many of which are small businesses, will be paid.

At present, construction firms may furnish security on a federal construction project:

1. By securing a bond written by a corporate surety, that must be vetted and approved by the U.S. Department of Treasury;
2. By posting an "eligible obligation," i.e. a U.S.-backed security, in lieu of a surety bond. The security is pledged directly and deposited with the federal government until the contract is complete; or
3. By securing a bond from an unlicensed individual, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property owned in fee simple.

Individual sureties, allowed in item 3 above, neither are subject to the same vetting and scrutiny as corporate sureties, nor are they required to relinquish the custody and control of the assets that they pledge to secure their bonds. This lack of meaningful oversight has resulted in documented cases where assets pledged by individual sureties have proven to be illusory or insufficient, causing substantial financial harm to the federal government, to taxpayers, and to subcontractors and suppliers.

H.R. 3534, the "Security in Bonding Act of 2011," will remedy this significant problem by requiring individual sureties to pledge solely those assets described as "eligible obligations" and to deposit them in the custody and control of the federal government. By doing so, H.R. 3534, eliminates future instances where individual surety bonds are pledged with insufficient or illusory assets. Thus, if an individual surety bond is furnished in the future, the small businesses which provide goods and services on those federal construction contracts will not need to worry about the integrity of their payment bond remedy.

Thank you again for your leadership on this critical issue. We strongly support your legislation.

Yours sincerely,

National Association of Surety Bond Producers
NASBP
 1140 19th Street, NW Suite 800
 Washington, DC 20036
 202-686-3700
 Contact: Larry LeClair, Director, Government Relations

Associated Builders and Contractors (ABC)
 4250 North Fairfax Drive, 9th Floor
 Arlington, VA 22203
 703-812-2041
 Contact: Liam P. Donovan, Director, Legislative Affairs

American Insurance Association (AIA)
 2101 L Street, NW, Suite 400
 Washington, DC 20037
 202-828-7100
 Contact: Melissa W. Shelk , Vice President - Federal Affairs

Mechanical Contractors Association of America
(MCAA)
 1385 Piccard Drive
 Rockville, MD 20850
 301-869-5800
 Contact: John McNerney, General Counsel

National Electrical Contractors Association (NECA)
 3 Bethesda Metro Center, Suite 1100
 Bethesda, MD 20814
 301-215-4522
 Contact: Lake A. Coulson, Executive Director
 Government Affairs

Sheet Metal and Air Conditioning Contractors' National
Association (SMACNA)
 Capitol Hill Office
 305 4th Street, NE
 Washington, DC 20002-5815
 202-547-8202
 Contact: Stanley E. Kolbe, Jr., Director, Legislative Affairs

The Surety & Fidelity Association of America (SFAA)
 1101 Connecticut Avenue, NW, Suite 800
 Washington, DC 20036
 202-463-0600
 Contact: Lenore Marema, Vice President of Government Affairs

American Subcontractors Association, Inc. (ASA)
 1004 Duke Street
 Alexandria, VA 22314
 703-684-3450
 Contact: Franklin Davis, Director of Government Relations

Associated General Contractors of America (AGC)
 2300 Wilson Blvd., Suite 400
 Arlington, VA 22201
 703-548-3118
 Contact: Marco Giamberardino, Senior Director, Federal & Heavy Construction Division and Sean O'Neil, Director Congressional Relations, Infrastructure Advancement

National Association of Minority Contractors (NAMC)
 The Ronald Reagan House Office Building, Suite 700
 1300 Pennsylvania Avenue, NW
 Washington, DC 20004
 (410) 268-9227
 Contact: Hamilton V. Bowser, Sr., P.E.
 President Emeritus and
 Former Chair, Bonding Committee NAMC

Property Casualty Insurers Association of America
(PCI)
 444 North Capitol Street, NW
 Suite 801
 Washington, D.C. 20001
 202-639-0490
 Contact: Ben McKay, Senior Vice President, Federal Government Relations



WOMEN CONSTRUCTION OWNERS AND EXECUTIVES ASSOCIATION

TESTIMONY OF

KAREN PECORA-BARBOUR
MEMBER
COUNCIL OF 200

&

PRESIDENT OF THE BARBOUR GROUP, LLC
A SMALL BUSINESS – WOMAN OWNED FIRM
US SBA SMALL BUSINESS PERSON OF THE YEAR (MD) 2008

SERVICING CONTRACTORS IN NEED OF CONSTRUCTION BONDS AND
COMMERCIAL INSURANCE

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

ON

CONSTRUCTION CONTRACTING AND THE NEED TO STREAMLINE AND
INCREASE THE EFFICIENCY OF THE SMALL BUSINESS
ADMINISTRATION BOND GUARANTY PROGRAM

AND

THE NEED FOR FEDERAL CONTRACTING AGENCIES TO STOP DE-
BUNDLING/CONSOLIDATING OF CONSTRUCTION CONTRACTS

AND

TO CREATE A COUNCIL TO PRE-APPROVE AND SCREEN INDIVIDUAL
SURETIES IN ORDER FOR CONTRACTING OFFICERS TO POSSESS A LIST
OF ACCEPTABLE INDIVIDUAL SURETIES THAT COMPLY WITH
FAR 28.203

FEBRUARY 9, 2012

www.thebarbourgroup.com | Surety Bonds | Commercial Insurance

20 Liberty St, Suite 2D | Westminster, MD 21157 | 410.876.9610 | Toll Free 866.876.9610 | Fax 410.876.9954

Mr. Chairman and Members of the Subcommittee, thank you for allowing me to present information to you. I am a member of Women Construction Owners and Executives. Today, you will no doubt hear about the barriers that prevent small businesses from securing **meaningful** work from federal agencies. But, the biggest barrier to small business contractors is surety bonding. You will hear that programs exist to help educate small business on bonding, but few, if any, guaranty the contractor that they will be able to qualify for a bond upon graduation of such a program. There are ways to overcome this issue which I will present to you below.

At present, I am the owner and founder of The Barbour Group. Established in 2002 as an independent insurance agency, our focus is on construction bonding and commercial insurance. The Barbour Group primarily services the surety needs of a wide range of construction clientele, from startups to medium-sized companies (\$50M - \$100M) to large firms with more than \$100M in annual gross revenue, including Fortune 1000 companies. Winner of multiple industry awards and holder of several key certifications, the agency continues to enjoy consecutive double-digit sales growth.

We are nationally known as one of the most knowledgeable and creative brokers in the business, providing a comprehensive suite of surety bonds for the construction industry, from Alaska to Puerto Rico. Prior to starting my agency, I was a partner of Barbour Construction Corp. (trading as Specialized Metals) for 10 years. The company performed work throughout the Mid-Atlantic region as a steel erection and metal fabrication subcontractor. I am proud to state that we fabricated and installed all the metal work in the Washington Monument, including the steel casings to house the glass membrane.

Serving as an underwriter for two notable carriers for 9 years, an agent for 8 years for two brokerage firms in the DC Metropolitan Area, my experience developed relationships with key strategic partners and industry leaders. At times USACE has asked for my consultation on small business issues. In 1998, I formed the Professional Council of General Construction – a forum, lasting two years, consisting of key personnel of the Baltimore Army Corps of Engineers and key members of various construction trade associations to openly discuss and resolve issues surrounding certain procurement models negatively impacting small businesses.

My insurance agency has received numerous awards and distinctions for our contributions to the success of contractors in the building industry, including selection as one of nine women entrepreneurs to participate in the 2009 Ernst & Young Entrepreneurial Winning Women™ program. I was named 2008 Maryland Small Business Person of the Year by the U.S. Small Business Administration (SBA) – the first surety agent to receive this SBA top honor. I was also honored as one of The Daily Record's 2010 Innovators of the Year for enabling success for small businesses nationwide.

The Governor of Maryland has appointed me his Co-Chair for The Governor's Commission on Small Business and I also serve as Vice Chair for the Small Business Development Center (SBDC) for the State of Maryland, while representing my community as a Board Member for the Economic Development Commission for State of Maryland.

WRITTEN TESTIMONY:

Small Business Administration's (SBA) Bond Guaranty Program:

The American Recovery Reinvestment Act when passed included an amendment that increased the ability of the SBA to guaranty up to 90% of performance and payment bond for a participating surety company for construction projects having a contract value of \$2 million to projects having a contract value of \$5 million, with discretionary authority to cover individual contracts up to \$10 million. ARRA also increased the SBA bond program eligibility standards from \$7 million in sales (average over three years) to that of the NAICS codes for small business. With the sunset of ARRA, the project cap for SBA is back to \$2 million. Thankfully, however, the sales cap under ARRA remains.

SBA Sales Cap is a Disconnect with Set Aside Programs

Much of the set aside contracts for 8(a)s, WOSBs, SDBs, HUB Zone, VOBs and/or SDVOBs are too large for SBA consideration now. Currently, The Veterans First Contracting Program, Department of Veterans Affairs (VA), is the only sole-source contract acquisition program that enables non-competitively bid contracts for Veterans. **This program authorizes VA contracting officers to sole-source projects up to \$5 million to VOB and SDVOBs** (<http://www1.va.gov/oamm/bf/oa/il07-08.pdf>).

However, many veterans coming back from Iraq are not in the best financial health and have credit scores that are below the comfort level of many corporate sureties. Unless the ceiling cap for SBA is raised to at least \$5 million, bonding capacity will not be enabled for the sole source projects above as the current SBA cap is set at \$2 million. As for the 8(a) program, the Federal Government can sole source projects up to \$4 million. However, few 8(a) contractors can obtain bonding at this level without SBA assistance and SBA currently cannot help due to its current \$2 million contract ceiling price.

- Reinstated the bond limits for the SBA Bond Program under ARRA to enable SBA to consider projects up to \$5 million with discretionary authority to consider individual projects up to \$10 million.

Understanding MATOC and shortcomings of SBA

MATOC, Multiple Award Task Order Contract, is a common contract delivery vehicle used by Department of Defense agencies. It is established for small business contractors. Here, the Government will typically make 1 to 7 contract awards to separate contractors based on the agency's "best interests." Such contracts typically have a base year and 4 options years to be exercised unilaterally by the Government. Winning such a contract at the end of fifth term as an 8(A) contractor can maintain an 8(A) contractor for an additional five years in the program.

Under the MATOC, each contractor could receive up to \$10 million in awards annually. The timing of and amount of the awards are not certain and subject to the ongoing needs of the agency. The contractor is not guaranteed any task orders under the MATOC. The problem arises when the contractor's surety treats the full \$10 million contract award as committed-project-

backlog, irrespective of actual MATOC awards. This underwriting approach significantly reduces a contractor's capacity for additional bonding.

Many MATOC vehicles require that the contractor need only post a \$1 million bond each year at the onset of each term. If the contractor performs more than \$1 million in projects for the year, then additional bond premium is billed against any additional work.

The \$1 million bond is not an issue for many small businesses. **The issue is that MATOCs require the following:**

"Contractor shall furnish proof in writing from their certified bonding company that they can obtain \$10,000,000 dollars' worth of bonds each year. The Contractor's proposal shall include a letter from his/her bonding company, which certifies the contractor's ability to obtain bonding up to the Maximum Award Amount of \$10,000,000 each year. Failure to provide said letter with the contractor's proposal will make the offeror ineligible for award."

The SBA cannot help. They cannot provide such a \$10 million bond support letter even though the initial bond is for \$1 million as stated above.

AGAIN, REINSTATE THE BOND LIMITS FOR SBA BOND PROGRAM UNDER ARRA TO ALLOW SBA TO PROVIDE \$10 MILLION BOND CAPACITY LETTERS

- If SBA could have discretionary authority to consider projects up to \$10 million as they did under ARRA, they could approve bond support letters for MATOCs and avoid the need of the disadvantaged contractor from partnering with big business and foregoing 50% or more of the profit.

One SBA Program – Don't Consolidate – Allow Only Plan A

At present, there are two programs/plans for bonding with the SBA:

- Prior Approval Program (Sec 411 (a) Small Business Investment Act) – Plan A
- Preferred Program (Sec 411 (a) (3) Small Business Investment Act) – Plan B

PLAN A requires that each contract bond submission is reviewed and approved either by the Denver or Seattle Office of the SBA and simultaneously with the participating surety. (Office location is determined by physical location of the contractor.) I work with both offices of SBA.

PLAN B allows a surety company to authorize and issue bonds and pay claims without SBA's prior approval and review. The SBA will perform audits of the surety underwriting and bond files at least once every three years.

Unlike Plan A, Under PLAN B, it is typical for the corporate sureties not to implement all of the underwriting caveats the SBA Bond Guaranty Program has to offer. For example, the SBA will include the unused portion of a contractor's bank line of credit as a current asset to the current financial statement and often extend up to 10 times working capital (current assets minus current liabilities) to compute the contractors aggregate bond limit. Working capital is key to setting bonding capacity limits for a

contractor. For example, if a contractor only has \$10,000 in working capital but a \$100,000 unused line of credit, the contractor can receive under SBA \$1,100,000 in bond capacity versus \$100,000!!

As an industry standard, corporate sureties will not consider a line of credit as additional working capital.

Under PLAN A, the bonding agent has direct access to the SBA offices. The SBA offices will go above and beyond to help agents and contractors in the program succeed and will provide guidance to the agent on enabling more capacity for the contractor.

Further, the differences between PLAN A and PLAN B, as addressed in this letter, are not clearly evident to contractors. Contractors are not aware that PLAN B may not provide as much bonding capacity as Plan A. (Plan B typically does not weigh in the unused portion of the bank line to increase working capital). When a contractor is declined surety credit under PLAN B, he or she may not know that they can resubmit their bond request under PLAN A. Having one SBA Plan would eliminate this precarious issue.

SBA and the hindering of Joint Ventures

The SBA can consider joint ventures (JV) but the new ceiling cap for annual sales cannot breach the NAICs limitation. While the sales cap is generous, the SBA will add in the sales of the non-SBA JV partner which could be in the hundreds of millions. This add-in will preclude the bonding for the JV entity with SBA. As an aside, few corporate sureties will support JV relationships for small business. Also, with a project cap of \$2 million, the pluses to JV make no sense.

- Change the regulation to only bond the small business contractor under the SBA and have the larger JV partner provide a bond from their surety (co-surety relationship).
- Allow regulation to only consider the sales of the SBA bond client so as not to disallow the JV's total sales of the two parties from exceeding the size standards.
- Again, reinstate the limits provided by ARRA for SBA - \$5 million single with discretionary authority to consider \$10 million projects – as anything less would not be conducive to JV.

SBA and Teaming Agreements

The SBA Bond Guaranty Program cannot accept teaming agreements, such as those found at www.sba.gov. Such agreements delineate the responsibilities of each partner and outline their working relationship per project. Here, the small business contractor is the prime or general contractor and typically partners or teams with a major (big business) subcontractor. The subcontractor can indemnify the prime contractor against any and all loss or provide subcontractor performance and payment bonds to the prime contractor.

Current regulation prohibits the SBA from discounting the teaming partner's sales and amount of work they are performing as a subcontractor to the small business contractor. Unlike joint ventures agreements, there is no joint and several liability with a teaming agreement if the big business teaming partner bonds back their portion of work (typically 80%) in lieu of joint indemnification.

Example: Small Business Prime has a \$5 million project but needs support in performing the work. He/She teams with a larger business and subcontracts out 80% of the work to the subcontractor. The subcontractor provides a bond back to the small business prime. Small Business prime is self-performing

\$1 million dollars or work. This \$1 million is under the current bond cap of \$2 million. With such an arrangement in place, an exception could be made to consider larger work outside the current SBA limits.

Reducing Cost and Increasing Efficiencies for Surety Agents

The SBA Bond Program is an expensive program for agents to utilize. It is primarily the small, independent bonding agencies that broker SBA bonds. And, such agents have limited resources. It takes 1.0 to 1.5 hours to input an underwriting file into the SBA's electronic system by experienced personnel. A hard copy of the file must be sent to the SBA and to the surety. More often than not, we are given last minute notification from the contractor that a bond is needed. The federal government requires that performance and payment bonds be supplied within 10 days after contract award.

- It would be more cost effective if the SBA forms could be scanned and emailed with acceptance of electronic signatures.

Moreover, an approval for a performance and payment bond cannot be obtained without the SBA having a check made payable to the SBA in the amount of \$7.29 per thousand of the contract value.

- It would be more cost effective to have the contractor to "pay by fax." This process of payment is common and used by my agency as an option for payment on non SBA accounts. The check is received via fax and sent to our bank electronically. Another option would be to wire the money to SBA.

De-Bundling/De-Consolidation of Federal Contracts

Much of the stimulus funds received for federal construction contracts from the eyes of a small business contractor fueled large construction projects, such as hospitals and new construction ranging from \$450,000,000 to over \$1 billion in value. Very little **meaningful** work trickled down to small businesses. By the time the large general contractors had their out-reach sessions for small business, most all of the major sub-trade work was already under contract, leaving just "crumbs" for minority and small business firms.

One such small business emailed me the following:

"Please see the item regarding bundling for Federal Contracts. This is very important for our small construction businesses to respond to as for the past eight years almost all jobs in this marketplace have been bundled. When this happens small business does not have a chance and the larger contractors bid (price) shop the projects again and again. In addition, they are only required to give out 27% of the jobs to small business by law. . Since the majority of the companies in this country are small and because small business employs more people than large businesses, this has been very unfairly skewed and our small business community has gotten largely nothing. Senator Cardin sponsored a bill a year ago to ask Contracting Officers for reasoning for doing this when letting out projects. I think now their reasoning is that they can save 10% overall on the contracts. We must fight this as a group. The General Contractors mark up their jobs a few percentage points after they have covered all expenses on the jobs. This is the same thing that the smaller companies do. There is less need for Federal Contracting Officers when the jobs are bundled but the overhead is shifted to the General Contractors as they need personnel to run the jobs for them. The Largest General Contractors that get these bundled contracts may not even have offices in this area and then take the revenues earned out of this market place and spend it elsewhere even though our taxes support their initiatives. We need to employ our local workforce in this time of recession and support our small business community. This must now be responded to timely as our businesses in this marketplace have not been given the opportunities that are available. I have counted 67 billion dollars in construction bundled jobs in this region this year alone. Almost nothing has been given to the small business community in construction per Federal Biz Ops. Imagine how we could grow with these opportunities as a group. Bundling has been done by the Army Corp of Engineers in two

large Contracts that have tied up the majority of repair and small construction work in the next three years to only one or two General Contractors. This involves work in virtually every trade. If work is needed on these bases, it goes through the General Contractor or perhaps they will self-perform only. The largest companies get bigger and bigger and the small ones go out of business. With numbers, we may be successful. Thank you for your time and help. It was good seeing you last week at another successful function. Cheryl London Chereco Co., Inc.” (Chereco is a woman owned firm in Maryland that performs glass and glazing work)

Above is just one example of the many emails I received regarding bundling. The new term small business contractors are hearing is consolidation in lieu of bundling. The effect is nonetheless the same. Bundling or consolidating contracts is an obstacle for small businesses.

- Support legislation that will prevent unnecessary bundling/consolidation of federal construction projects to allow more small business participation at the prime level.

Credit Inquiries and Impact on Bonding

Owners and spouses of small businesses are required to provide personal and corporate indemnity to surety companies in order to be extended any form of bonding credit. Surety is not insurance. If a contractor defaults and the surety makes any payments to suppliers and/or the project owner, the surety will seek subrogation against the owners, spouses and principal on the bond (the small business) to be made whole. This is why you will often hear surety companies say that they underwrite risks based on a zero loss ratio. As I am sure you are aware, sureties have losses and often there is very little left to recoup of the small business and its owners.

Before a small business can be considered for bonding, the surety company will pull a credit report on the owners and spouses. If the corporate surety for some reason does not find this contractor a fit for their company, the surety broker will send the contract file to another market, which in turn, will also pull credit. In some cases, several tries may be needed before a solid proposal can be provided by the broker. In the meantime, for every report pulled, the credit scoring companies will deduct points, anywhere from 4 to 10 points, for each credit inquiry.

Not only do corporate sureties pull credit reports on owners and spouses of small businesses, but so do vendors and banks. While owners and spouses may have fair credit, hovering around 700, by the time outside parties pull credit, the inquiries alone could drop the score to unfavorable levels.

Each time a personal credit is pulled, the company making the inquiry is listed. So, if I, as the broker, send a small business account to Surety A and they decline, the next surety, Surety B will see that Surety A pulled credit and wonder why Surety A did not approve the account. Disclosing the name of the company making the inquiry on the credit report is a Privacy Act issue. Disclosing the inquirer should be made only to the individual under credit investigation, no one else.

Big business does not have this issue. Most large companies do not personally indemnify. Sureties here rely on the credit reports such as Dunn and Bradstreet.

- Support legislation to stop credit reporting authorities from deducting any points for inquiries from personal credit scores when the inquiry was made for the risk evaluation of the small business.
- Support legislation not to openly disclose and name the entity making the inquiry on the personal credit report for any individual/consumer.

Individual Sureties as allowed by FAR 28.203

In the summer of 2005, five corporate sureties closed down their bond operations within 30 days of each other. Those sureties were Atlantic Mutual, Harleysville, Frontier, XL Surety, and Crum and Foster. Last week, a corporate surety who focused on serving small business closed its doors. One day it was rated A+ by Am Best and nearly the next day it was rated C. The company is now in bankruptcy. Since most sureties who service small business contractors are small themselves in comparison to the top ten sureties, they often require collateral and/or funds control to hedge bond losses. Today, many agents and contractors can't get news as to how to get their collateral back from First Sealord Surety, the recently bankrupt corporate surety. And, owners of the projects are requesting replacement bonds as the surety no longer meet the contractual requirements, a premium that the contractor and/or its agent may have to absorb.

When corporate sureties close they leave their contractors "on the street" to be cherry picked by the corporate sureties who elect to help them. Many of the contractors find themselves without sufficient bonding capacities.

My firm services many construction firms that are minority, women and vet owned. They need assistance. Individual surety has helped many. In fact, there are over 7,000 success stories. Individual surety as allowed by FAR 28.203 gives contractors an option. However, it is interesting to note that most individual surety bonds were not accepted by contracting officers where the contractor was a minority or women owned firm. Data can be provided to you if you so prefer.

While many federal agencies accept individual surety bonds, the Baltimore Army COE district will not. The individual surety bonds that are provided guaranty a cash payout by a leading FDIC bank. The bank signs off on the commitment to the federal agency. Unlike what you may hear, the federal agency is not getting coal but cash.

Some will say that if the individual surety guarantees cash then why can't that surety post a letter of credit? The reason is that a letter of credit (LOC) provides no defenses. If the contractor is declared to be in default, the federal agency calls the LOC. The contractor then has to sue the federal government for any wrong doing. Under a bond, the surety has defenses that can protect the contractor. Individual sureties do not want to be in a position, I assume logically, to sue the federal government for their money. It would preempt the entire individual surety process as allowed by FAR.

There are many interpretations of the FAR and they vary with every contracting officer and/or agency. It makes it very difficult to provide assurance to contractors that the individual surety bonds will be accepted.

Individual surety is a tool to groom contractors back into corporate surety credit. Some now enjoy preferred rates from leading surety companies. With the harsh economic times that we are in, small business contractors' financial conditions will not be stellar. For those that can weather the storm, an excess lines market for bonding needs to exist—individual surety. It is the only one.

- Rather than have each contracting officer determine the acceptance of the individual surety bond, **support legislation** to mandate that the federal government create a council for federal contracting agencies to pre-screen individual sureties. Those that pass the FAR requirements are to be enrolled on a list of acceptable individual sureties. The individual surety should be able to provide their data and have their attorneys present to address any legal issues with regard to FAR compliance. There should also be an appeal process if the individual surety believes that they were not treated fairly. This will also alleviate any concerns that bonding agents will have with regard to FAR compliance.

Please keep in mind that there is currently no list of approved individual sureties as there is with corporate sureties by the US Treasury's 570 Circular. The US Treasury does not approve individual sureties, nor does any insurance administration of any state. Individual sureties are not regulated and are unable to obtain any certificate of authority from any state, as well. But as mentioned with First Seaford Surety, regulation is not always fail safe.

Some will say that the US Treasury should approve individual sureties. In the past they have refused. Further, they may not be impartial given their long standing relationships with corporate sureties. It may be best to create a federal council who better understands the FAR requirements, the federal contracting vehicles and the needs for small business.

Miller Act Compliance Disclosure & Retention Reform

Miller Act

According to FAR 28.102-1 and pursuant to 40 U.S.C. 3132, for construction contracts greater than \$30,000, but not greater than \$150,000, the contracting officer shall select two or more of the following payment protections, giving particular consideration to inclusion of an irrevocable letter of credit as one of the selected alternatives. Contracts exceeding \$150,000 (Miller Act) require payment and performance bonds.

My first-hand experience on federal contracts in excess of \$300,000,000, the federal agency allowed the bonds to be phased during the duration of the project, or incremental phasing. On one project exceeding \$650,000,000, the contractor's surety would not provide a bond even though initially it said it would. The contractor asked the federal agency to accept sub-guard in lieu of a bond. Sub-guard is a product of Zurich Insurance. It provides protection to General Contractors against subcontractor failure. However, it offers no protection for the subcontractors against non-performance of the General Contractor. However some owners will waive the General Contractor's bond if they feel comfortable with the blanket

protection against subcontractor failure afforded by sub-guard. Additionally, it is not uncommon to hear in my industry that the federal agency took the contractor's corporate guaranty in lieu of a bond on mega projects (\$1 billion or more). Here there is no Miller Act protection for small business contractors.

- Support legislation for federal contracting officers to disclose what type of security was provided by the General Contractor and accepted by the contracting officer in support of the contract award: performance and payment bond, performance bond only, payment bond only, letter of credit, corporate guarantee or sub-guard.

Mr. Chairman and Member of the Committee, this concludes my written testimony. I thank you for your time and consideration and on behalf of WCOE, your help in alleviating barriers to bonding for small business is exceptionally important. My contact information is below should you have any questions or comments.

Retention Reform for FAR

At present there are three FAR clauses found that address retention. 32.102 gives reason why retention can be withheld from general contractors by contracting officers, 52.232-5 provides the amount that can be withheld by the contracting officer for poor performance, and 52-232-27 that allows a flow down to subcontractors to allow subcontractors to withhold retention from their subcontractors. See below

32.103 Progress payments under construction contracts.

When satisfactory progress has not been achieved by a contractor during any period for which a progress payment is to be made, a percentage of the progress payment may be retained. Retainage should not be used as a substitute for good contract management, and the contracting officer should not withhold funds without cause. Determinations to retain and the specific amount to be withheld shall be made by the contracting officers on a case-by-case basis. Such decisions will be based on the contracting officer's assessment of past performance and the likelihood that such performance will continue. The amount of retainage withheld shall not exceed 10 percent of the approved estimated amount in accordance with the terms of the contract and may be adjusted as the contract approaches completion to recognize better than expected performance, the ability to rely on alternative safeguards, and other factors. Upon completion of all contract requirements, retained amounts shall be paid promptly.

52.232-5 Payments under Fixed-Price Construction Contracts.

(e) *Retainage.* If the Contracting Officer finds that satisfactory progress was achieved during any period for which a progress payment is to be made, the Contracting Officer shall authorize payment to be made in full. However, if satisfactory progress has not been made, the Contracting Officer may retain a maximum of 10 percent of the amount of the payment until satisfactory progress is achieved. When the work is substantially complete, the Contracting Officer may retain from previously withheld funds and future progress payments that amount the Contracting Officer considers adequate for protection of the Government and shall release to the Contractor all the remaining withheld funds. Also, on completion and acceptance of each separate building, public work, or other division of the contract, for which the price is stated separately in the contract, payment shall be made for the completed work without retention of a percentage.

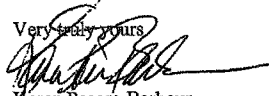
52.232-27 Prompt Payment for Construction Contracts.

(1) *Retainage permitted.* Permit the Contractor or a subcontractor to retain (without cause) a specified percentage of each progress payment otherwise due to a subcontractor for satisfactory performance under the subcontract without incurring any obligation to pay a late payment interest penalty, in accordance with terms and conditions agreed to by the parties to the subcontract, giving such recognition as the parties deem appropriate to the ability of a subcontractor to furnish a performance bond and a payment bond.

While general contractors may not have any retention withheld by the contracting officer, they will nonetheless hold retention from their subcontractor's payments, up to 10% without cause. And, the general contractors will not release any retention to the subcontractor until all the work is completed. Given the extreme size of many federal projects, the subcontractors may not see that retention (profit) for several years.

- Support legislation to change FAR retention clauses to disallow any retention to be withheld from the subcontractor (if performing satisfactorily) by the general contractor if no retention was withheld from the general contractor by the contracting officer or if the subcontractor has posted a bond.
- Support legislation to mandate that the general contractor must release the subcontractors' retention upon successful completion of the subcontractor's work.

Very truly yours,


Karen Pecora-Barbour
President



United States Department of the Interior

OFFICE OF THE SECRETARY

Washington, DC 20240

SEP 08 2009



Department of the Interior Acquisition Policy Release (DIAPR) 2009-15

Subject: Individual Surety Bonds

References: Department of the Interior (DOI) Office of Inspector General (OIG) June 29, 2007, memorandum, *Management Advisory of Investigative Results: Individual Surety Bonds*, OIG Case Number OI-NM-06-0174-I; and Federal Acquisition Regulation (FAR) Part 28, *Bonds and Insurance*

1. Purpose:

The purpose of this DIAPR is to remind contracting personnel of key FAR requirements associated with accepting an individual surety bond for a contract to protect the Federal Government from financial losses.

2. Effective Date: Effective upon signature.

3. Expiration Date:

This DIAPR will remain in effect until superseded or cancelled.

4. Background and Explanation:

The OIG investigated allegations of misuse of individual surety bonds for construction contracts. The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about the individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System.

The Miller Act, 40 U.S.C. 3131, requires performance and payment bonds for any construction contract exceeding \$100,000, with some limited exceptions. Agencies must obtain adequate security for bonds with contracts for supplies or services, including construction. Acceptable forms of security include corporate or individual surety bonds, as well as others described in FAR Part 28.204.

The majority of surety bonds for government contracts are supplied by corporate sureties. Corporate sureties are companies approved by the Treasury Department to provide surety bonds. However, the FAR permits a contractor to secure bonds from "individual sureties" if approved by the CO.

FAR Part 28.203, *Acceptability of Individual Sureties*, outlines procedures COs must follow to determine the acceptability of an individual surety.

5. Action Required:

To reduce the risk of financial loss to the Department from contracts backed with individual surety payment and performance bonds, DOI COs must:

- Familiarize themselves with FAR requirements for individual surety bonds.
- Identify and verify assets, backing individual surety payment and performance bonds, prior to accepting them.
- Confirm and ensure that the government has control over pledged assets through the duration of the contract.
- Vet matters involving the acceptance of individual surety bonds with the Office of the Solicitor.
- Verify whether individual sureties are suspended or debarred.

6. Additional Information:

Please disseminate this guidance within your bureau. It will also be available on the web at <http://www.doi.gov/pam/diapr.html>. Questions may be directed to Brigitte Meffert, Senior Procurement Analyst, Office of Acquisition and Property Management, at (202) 208-3348, or via e-mail at Brigitte_Meffert@ios.doi.gov.



Debra E. Sonderman
Director, Office of Acquisition and Property Management
and Senior Procurement Executive

**Subcommittee on Contracting and Workforce
Hearing on February 9, 2012
Questions for the Record**

James Dalton, US Army Corps of Engineers (Corps)

1. Does the Corps have the technical expertise to develop, evaluate, and award construction contracts or does it rely on a general contractor to fulfill that role?
2. A construction project manager typically provides the contracting officer with the project spec/requirements documents and a list of suggested sources.
 - a. Is the project manager taught to consider developing specification in a way that maximizes the use of small businesses?
 - b. What stage of the acquisition process are the Office of Small and Disadvantaged Business Utilization and the Procurement Center Representative included in the review of solicitations for contract bundling and small business set-aside purposes?
3. DoD's January 2002, "Small Business Participation in Consolidated Contracts," available at <http://www.acq.osd.mil/osbp/news/consolidationmemo.pdf>, states that DoD recognizes that consolidation of requirements previously bought on smaller contracts in some instances may be deemed necessary and justified, but efforts must be made to avoid unnecessary and unjustified bundling of requirements and to mitigate the negative impact that contract bundling has on small business concerns.
 - a. How is the Corps implementing this policy?
 - b. When and what kind of contract bundling analysis is done to evaluate construction requirement?
4. DoD's regulations allow for the issuance of Multiple Award Task Order Contracts (MATOC) for construction services with multiple awardees.
 - a. Please explain the scope of these contracts.
 - b. What analysis is performed to ensure that consolidation of requirements under MATOC has not morphed into contract bundling?

5. With MATOC contracts, the awardees constitute a pool of contractors who then compete for subsequent task orders. A contractor who is not a part of the MATOC pool to compete for task orders over a three to five year period may not be able to compete for the next project as a prime contractor for a long time.
 - a. What percentage of contract awardees are small businesses and what percentage are task order awardees?
 - b. Who monitors the subcontracting plan for MATOCs or are the contractors managing themselves?
 - c. How are small businesses able to compete for subcontracting opportunities under the MATOC?
6. How do you ensure that the Corps is following the prompt payment requirements and that subcontractors are also being paid promptly?
7. What is Corps policy on contract bundling and consolidation, sealed bid contracts, reverse auctions, retention and bond requirements for construction contracts contract administration (enforcement and monitoring of subcontracting plans)? If yes, please provide.
8. What outreach is conducted to ensure small businesses are included in the Corps procurement opportunities as prime contractors and as subcontractors?
9. Since small businesses play a significant role as subcontractors on construction projects, how does Corps encourage prime contractors to subcontract with small businesses past their first tier subcontractors?
10. In your testimony, you indicate that Corps has a 98.5 percent record of paying contractors, at the prime contract level, in a timely manner in 2010 and 2011. The Administration says it is trying to pay small businesses faster than required under the prompt payment rules.
 - a. Does the Corps have a different prompt payment rule for small business prime contractors?
 - b. Is Corps aware of problems with prime contractor's timely payment to its subcontractors on their projects?

- c. Is there any reason why we distinguish between architect & engineering (A&E) contractors and construction contractors when it comes to prompt payment?
 - d. If payment is not made after a proper invoice is submitted, who is the contractor suppose to call for assistance?
- 11. If the government can withhold payment for performance related reasons, why is retainage necessary?
- 12. If a surety bond is required to guarantee payment and performance under construction contracts, under what circumstances would the Corps' also find retainage desirable? Does the answer change if the contractor is a small business?
- 13. Are bonding issues an impediment to the Corps using small business construction contractors? To what extent does the SBA Surety Bond program help?
- 14. On the MATOC construction contracts, the contractor is required to furnish proof from a certified bonding company that they can obtain \$10 million worth of bonds each year. Given that a small business specialty contractor cannot have receipts over \$14 million a year, how feasible is it for small businesses to compete for these projects? What is the Corps doing to help small businesses in this area?
- 15. Construction contracts are awarded out of various Corps district offices.
 - a. Who makes the decision about whether a construction project will be issued out of the local district office or headquarters?
 - b. Does this decision influence whether local contractors are more likely to be used?
 - c. How many contracts were awarded in the district where the work was performed and what were they?
 - d. How many contracts were performed by workers in the district of the construction project?

**Subcommittee on Contracting and Workforce
Hearing on February 9, 2012
Questions for the Record**

William Guerin – GSA

1. According to your testimony, in FY 2011, GSA awarded 41 percent of all contract dollars to small businesses. What percentage of that was in the construction industry?
2. Does GSA have the expertise to prepare government construction specifications and drawings and other requirements document for construction projects?
3. When GSA is forecasting its acquisition opportunities, when do the acquisition officials and construction program managers discuss the small business opportunities with the GSA Office of Small Business Utilization (OSBU)?
4. In your testimony, you indicated that “PBS uses proven selection procedures that enable us to award contracts to deserving competitors who can offer the Government the best overall value.”
 - a. What are those “proven selection procedures” and who are the “deserving competitors”?
 - b. How do small businesses fit into this statement – are they deserving competitors?
5. In your testimony, you state that small businesses also have many opportunities to work on large GSA modernization and new construction projects, primarily as subcontractors.
 - a. Why isn’t using small businesses as prime contractors a priority on these projects?
 - b. Is there a bias towards or risk associated with awarding large construction projects to a small business?
6. Tell us about GSA’s experience with using internet reverse auctions for prime contractor selection.

- a. What is GSA's policy on use of reverse auctions for construction requirements?
 - b. How do small businesses fair?
7. In 1983, GSA abandoned the use of bid listing.
 - a. Can you explain the reasons for doing so and are those reasons still valid today given the Small Business Jobs Act requirement to use subcontractors used to develop proposals?
 - b. How do you explain GSA's rationale for not using bid listing when a number of states have adopted this practice?
8. The government is collecting data in the Federal Subcontracting Reporting System and the Electronic Subcontracting Reporting System to track subcontracting, so we have transparency with regards to subcontracting data.
 - a. How and is the data in these systems being used to monitor contractor compliance?
 - b. Is compliance with small business subcontracting plans a systemic problem that needs to be addressed or a series isolated incidents that resulted from a few contracting officers and contractors not following the regulations?
 - c. What is GSA's contract administration policy for construction projects specifically regarding the enforcement and monitoring of subcontracting plans and the limitation on subcontracting rules?
9. How does GSA ensure that the agency is following the prompt payment requirements and that subcontractors are also being paid promptly?
10. How does GSA evaluate a prime contractor's performance for delayed or late payment to subcontractors?
11. What is GSA's policy on contract bundling and consolidation, sealed bid contracts, reverse auctions, retention and bond requirements for construction

contracts contract administration (enforcement and monitoring of subcontracting plans)? If yes, please provide.

12. The Federal Acquisition Regulation requires surety bonds and authorizes the use of retainage on construction projects.
 - a. What is GSA's policy on retention and bond requirements?
 - b. If the government can withhold payment for performance related reasons, why is retainage necessary?
13. If a surety bond is required to guarantee payment and performance under construction contracts, under what circumstances would GSA also find retainage desirable? Does the answer change if the contractor is a small business?
14. Are bonding issues an impediment to GSA using small business construction contractors? To what extent does the SBA Surety Bond program help?
15. Many agencies, such as DoD use multiple award contracts for construction.
 - a. Does GSA use multiple award construction contracts? If so, how is potential bundling addressed?
 - b. When consolidating requirements, how does GSA ensure bundling is not the outcome and small businesses are not excluded as a result of the consolidation?
16. Construction contracts are awarded out of various GSA regional offices.
 - a. Who makes the decision about whether a construction project will be issued out of the regional office or headquarters?
 - b. Does this decision influence whether local contractors are more likely to be used?
 - c. How many contracts were awarded in the regional offices where the work was performed and what were they?
 - d. How many contracts were performed by workers in the region of the construction project?

**Subcommittee on Contracting and Workforce
Hearing on February 9, 2012
Questions for the Record**

Jeanne Hult - SBA

1. Please provide details on how the SBA Surety Bond program works and explain:
 - a. The differences between the Prior Approval Program (PAP) and Preferred Program and why are bonds rejected under the PAP
 - b. The program funding.
 - c. SBA measurements of success for the program – processing time, number of applicants, number of approved applicants, etc.
 - d. The percentage of claims on the guarantees SBA accepts and if SBA can partially honor a guarantee or must it 100% honor or deny a claim.
2. Currently, SBA cannot guarantee bonds over \$2 million; however, for 2 years SBA was permitted to issue bonds up to \$5 million. Please explain whether the increase led to increased defaults, volume of bonds, or increased costs for the program.
3. On a project like Army Corps of Engineers MATOC construction contracts, the contractor is required to furnish proof from a certified bonding company that they can obtain \$10,000,000 dollars worth of bonds each year. How does the SBA surety bond help a small business that wants to compete for this contract?
4. We have heard a number of complaints about the processing time. How long does it take for SBA to process a bond application? Does the processing time often impact the contractor's ability to compete on other jobs?
5. The SBA Bond Program is not an inexpensive program for agents to use. SBA charges the surety company 26% of the fee the surety charges the small business. SBA charges the small business .729% of the contract price for the

bond guarantee. This can be a significant amount for small businesses. On the average they pay around \$19,000 for a \$500,000 contract.

- a. Are there any plans to stabilize or decrease the fees?
 - b. What does SBA do with the fees?
6. According to your testimony, SBA will be publishing a proposed rule that will adopt a streamlined application process for any bond guarantee on a contract valued up to \$250,000 to reduce paperwork requirements. How many bonds does SBA guarantee under \$250,000?
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7. According to your testimony, SBA plans to make a number of changes to update, streamline, and simplify the surety bond regulations. What exactly are those changes and what is the schedule?
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 - a. Specifically, does SBA require notification of change orders in excess of what commercial sureties believe it is valuable to monitor?
 - b. Could this be the reason why more commercial sureties are not participating in SBA's program?
 - c. How is SBA addressing this problem and what does SBA plan to do to appropriately align its practices with commercial practices?

**Subcommittee on Contracting and Workforce
Hearing on February 9, 2012
Questions for the Record**

- 1. According to your testimony, in FY 2011, GSA awarded 41 percent of all contract dollars to small businesses. What percentage of that was in the construction industry?**

Of the \$1.4 billion (41 percent of total contract dollars awarded by GSA in FY11) of contracts GSA awarded to small businesses last year, approximately 27 percent was for construction contracts procured through GSA's Public Buildings Service (PBS).

- 2. Does GSA have the expertise to prepare government construction specifications and drawings and other requirements document for construction projects?**

Yes, GSA maintains the level of contracting and construction expertise required to develop construction specifications, drawings, and necessary documents; however, we typically contract out design services. GSA reviews the bidder submissions and awards the contract.

- 3. When GSA is forecasting its acquisition opportunities, when do the acquisition officials and construction program managers discuss the small business opportunities with the GSA Office of Small Business Utilization (OSBU)?**

GSA regional acquisition officials continually communicate with the regional small business offices. Additionally, GSA's national Office of Small Business Utilization receives quarterly updates from its regional offices and acquisition officials to update its Forecast of Contracting Opportunities (found online at <http://www.gsa.gov/portal/content/101163>).

- 4. In your testimony, you indicated that "PBS uses proven selection procedures that enable us to award contracts to deserving competitors who can offer the Government the best overall value."**

- a. What are those "proven selection procedures" and who are the "deserving competitors"?**

PBS primarily relies on procedures found in FAR Part 15 to select construction contractors. FAR Part 15 allows consideration of factors other than cost, such as management experience,

technical approach, and past performance, and allows for negotiation during the selection process. Evaluating both technical factors and price allows GSA to ensure that the selected contractor has the requisite qualifications and can provide the best value to the taxpayer.

b. How do small businesses fit into this statement – are they deserving competitors?

Yes. Small businesses, however, often lack the resources necessary to meet the requirements of prime contractors for our largest and most complex projects – new construction and major modernizations. GSA makes every effort to create prime contracting opportunities for small businesses on our smaller repair and alterations projects, as well as subcontracting opportunities on projects of all sizes.

5. In your testimony, you state that small businesses also have many opportunities to work on large GSA modernization and new construction projects, primarily as subcontractors.

a. Why isn't using small businesses as prime contractors a priority on these projects?

GSA understands the value of small businesses to our economy, and advocates for the participation of small businesses, including small disadvantaged, women-owned, HUBZone, veteran, and service-disabled veteran-owned small businesses, in its procurement process at both the prime and subcontracting levels. GSA has aggressive goals for small business participation in our acquisitions.

GSA does not preclude small businesses from bidding on GSA's new construction and modernization projects. However, small businesses often have difficulty obtaining prime contract awards due to the bonding and experience needed for these large, complex projects. As a result, GSA creates opportunities for small businesses to work as prime contractors on smaller repair and alteration projects and as subcontractors on larger projects. GSA's prime contractors on our large projects exceeding \$1.5 million must have small business plans and goals for these projects that are considered during the contract selection process. GSA then evaluates the small business subcontracting plan in relation to the small business subcontracting goals set for the project in the solicitation.

b. Is there a bias towards or risk associated with awarding large construction projects to a small business?

In the selection process, GSA considers each bidder's qualifications to meet the requirements outlined in the solicitation and makes an independent decision for each award based on these qualifications. Experience is one of the key factors in selecting a contractor for a large, complex project. Due to the limitations that small businesses typically have acquiring the bonds required under the Miller Act for GSA's projects, most construction projects with a value that

exceeds \$10 million are not ideal for small businesses. During the project planning process, GSA conducts market research to determine the availability of small businesses for each project.

6. Tell us about GSA's experience with using internet reverse auctions for prime contractor selection.

a. What is GSA's policy on use of reverse auctions for construction requirements?

PBS does not conduct reverse auctions for construction requirements and has no policy on the issue.

b. How do small businesses fair?

See above.

7. In 1983, GSA abandoned the use of bid listing.

a. Can you explain the reasons for doing so and are those reasons still valid today given the Small Business Jobs Act requirement to use subcontractors used to develop proposals?

According to GSA's 1983 Federal Register revision that removed bid listing requirements¹, listing of subcontractors' requirements resulted in award delays and higher procurement costs due to the rejection of low bids. We believe these concerns remain valid.

b. How do you explain GSA's rationale for not using bid listing when a number of states have adopted this practice?

In keeping with the Federal Acquisition Streamlining Act of 1994 and the Clinger-Cohen Act of 1996, GSA has established efficient and effective methods for conducting procurements for construction. Adding additional requirements to the process may result in higher procurement costs and award delays.

8. The government is collecting data in the Federal Subcontracting Reporting System and the Electronic Subcontracting Reporting System to track subcontracting, so we have transparency with regards to subcontracting data.

¹ See 48 Fed. Reg. 49,305 (1983).

a. How and is the data in these systems being used to monitor contractor compliance?

GSA uses data in the Electronic Subcontracting Reporting System (eSRS) to determine whether prime contractors are making progress toward, and successfully meeting, the small business goals established in their subcontracting plans. Contracting officers are trained to reject reports that are incomplete, omit data, or inaccurately report data; however, failure to meet the goals in the subcontracting plan is not a valid reason to reject the report. Contractors that fail to meet their goals because they did not award the anticipated number of contracts to small businesses may still be compliant with their subcontracting plan if they provided maximum opportunities to small businesses and documented those opportunities. Contracting officers can request assistance from the central or regional Offices of Small Business Utilization for support, if needed, to assist the contractor in finding ways to increase utilization of small businesses.

Additionally, the Small Business Administration can provide training on how to report using the eSRS. If the contractor is unsuccessful in its execution of its subcontracting plan by failing to make a "good faith effort" as defined by SBA regulatory guidance, the contracting officer can assess liquidated damages against the contractor. Further, the contracting officer shall rate/provide documentation on the contractor's successful or unsuccessful execution of its subcontracting plan which will be utilized in future contract consideration when GSA evaluates the contractor's past performance.

b. Is compliance with small business subcontracting plans a systemic problem that needs to be addressed or a series isolated incidents that resulted from a few contracting officers and contractors not following the regulations?

With the exception of a minimal number of isolated incidents, which were immediately addressed, GSA has not encountered problems with compliance with the Electronic Subcontracting Reporting System (eSRS).

c. What is GSA's contract administration policy for construction projects specifically regarding the enforcement and monitoring of subcontracting plans and the limitation on subcontracting rules?

GSA's contract administration and oversight process includes monitoring compliance with contract conditions. On contracts that include subcontracting plans, the contracting officer monitors the contractor's performance by reviewing semi-annual reports submitted through the Electronic Subcontracting Reporting System. The contracting officer evaluates the contractor's performance in obtaining the goals of the subcontracting plan to ensure the contractor is providing sufficient small business subcontracting opportunities.

9. How does GSA ensure that the agency is following the prompt payment requirements and that subcontractors are also being paid promptly?

GSA paid 98.5 percent of its invoices on time in FY 2010, and 98.8 percent in FY 2011. We continue to be proactive in ensuring that small businesses are paid in a timely manner. On January 24, GSA issued a memorandum entitled "New Requirements Related to Accelerated Payments to Small Businesses," which requires GSA to pay all small businesses within 15 days of receipt of relevant documents instead of 30 days.

For each construction payment, prime contractors are required to certify that payments to subcontractors and suppliers have been made from previous payments received under the contract. If we are notified that the prime contractors are not paying their subcontractors, our contracting officers reach out to the prime contractor and direct them to discuss the allegations with the subcontractor. Our contracting officers also provide information to subcontractors on payment bonds and their rights under the Miller Act.

10. How does GSA evaluate a prime contractor's performance for delayed or late payment to subcontractors?

GSA does not have contractual privity with subcontractors; our contractual responsibilities are to prime contractors. GSA does not evaluate the contractual relationship between the prime contractor and its subcontractors. Subcontractors can reach out to the GSA contracting officer regarding delayed or late payments and the contracting officer will facilitate communication with the prime and subcontractor to help resolve the issue. If the contracting officer finds that the payment was delayed without just cause, he or she can add a note to the prime contractor's performance evaluation.

11. What is GSA's policy on contract bundling and consolidation, sealed bid contracts, reverse auctions, retention and bond requirements for construction contracts contract administration (enforcement and monitoring of subcontracting plans)? If yes, please provide.

GSA does not have specific policies on contract bundling, consolidation, or reverse auctions. We have a supplemental policy on completing past performance evaluation in the Federal Contractor Performance Assessment Reporting System, which requires assessment of the contractor's achievement of the approved small business subcontracting plan.²

The FAR and the General Services Acquisition Manual (GSAM) give guidance on all acquisition methods. GSA follows the procedures outlined in FAR Part 14, Subpart 36.213 and GSAM Part 514, Subpart 536.213 when procuring construction services through the sealed bidding process, and applies the regulatory guidance of FAR Part 28 and GSAM Part 528 to determine the

² See PBS Procurement Instructional Bulletin 11-02 (2011). We have enclosed a copy of this policy.

applicability and requirements of bonding for certain construction and non-construction procurements. Retention is allowed under the FAR Payments under Fixed-Price Construction Contracts clause 52.232-5 and contracts are administered in accordance with this clause.

12. The Federal Acquisition Regulation requires surety bonds and authorizes the use of retainage on construction projects.

a. What is GSA's policy on retention and bond requirements?

GSA follows FAR and GSAM requirements in administering its construction contracts and does not have any additional policies regarding bonds or retention. The FAR allows for retention when the contractor is not making satisfactory progress on a job for protection of the Government's interest.

b. If the government can withhold payment for performance-related reasons, why is retainage necessary?

Retention is an important tool that helps the Federal Government hold contractors accountable and ensures that taxpayers receive a solid return on their investment. Retention is at the contracting officer's discretion and is not intended to adversely affect small businesses. In fact, if government retention will affect a subcontractor, the prime contractor is required under FAR 52.232 (Prompt Payments for Construction) to notify that subcontractor as well as GSA. Subcontractors who believe they are being treated unfairly may have recourse under the Miller Act and can contact GSA for assistance.

13. If a surety bond is required to guarantee payment and performance under construction contracts, under what circumstances would GSA also find retainage desirable? Does the answer change if the contractor is a small business?

The payment bond is required as security for the protection of those supplying labor or materials in the construction of public buildings. Public buildings are not subject to mechanics' liens, which are used in the private sector as recourse for nonpayment. The performance bond insures completion of the job if the prime contractor fails to perform. Retention is a tool for the government when a contractor is not making progress. It also ensures that the government is not overpaying progress payments. GSA does not consider business size in determining whether to enforce contract terms and clauses.

14. Are bonding issues an impediment to GSA using small business construction contractors? To what extent does the SBA Surety Bond program help?

Bonding can be an impediment to a small business participating in a procurement, particularly for our largest and most complex projects – new construction and major modernizations. Businesses qualify for bonding based partially on their financial capability and ability to perform. PBS routinely refers small businesses to the OSBU, which provides the contractor with information on SBA's many bonding resources.

15. Many agencies, such as DoD use multiple award contracts for construction.

a. Does GSA use multiple award construction contracts? If so, how is potential bundling addressed?

GSA has several regions that issue multiple award Indefinite Delivery Indefinite Quantity (IDIQ) contracts for smaller construction and repair and alteration projects. Many of these multiple award contracts, typically below \$150,000, are reserved solely for small businesses. These multiple award contracts ensure that we have sufficient contractors with contract personnel that meet our security clearance requirements to work in Federal buildings.

b. When consolidating requirements, how does GSA ensure bundling is not the outcome and small businesses are not excluded as a result of the consolidation?

GSA rarely uses bundled contracts for construction contracts. Since most construction projects represent discrete requirements, bundling as it is currently utilized is untenable for construction. Large new construction and major modernization projects are considered discrete requirements and are procured as such. Small businesses have many opportunities to participate in such projects at the subcontracting level. GSA requires small business plans as a part of our review process for selection of a prime contractor and sets aggressive small business subcontracting goals.

If there are reasonable and effective ways to do so, we can split separate and distinct requirements, as with the Robert A. Young Federal Building in Missouri. In many cases, however, dividing major construction projects into several separate requirements would create additional administrative burdens, result in a less well-integrated product, and cost the Federal government more money.

16. Construction contracts are awarded out of various GSA regional offices.

a. Who makes the decision about whether a construction project will be issued out of the regional office or headquarters?

In accordance with GSA's procedures and practices, construction contracts are awarded out of the regional offices. The regional offices are responsible for acquisition planning for their facilities.

b. Does this decision influence whether local contractors are more likely to be used?

No. The decision to use local contractors is not influenced by whether the contract is managed or awarded at a regional or headquarters office.

c. How many contracts were awarded in the regional offices where the work was performed and what were they?

GSA's construction projects are managed at the regional level and for that reason, our construction contracts are executed at the regional level.

d. How many contracts were performed by workers in the region of the construction project?

GSA does not track this information because many of these workers are hired at the subcontractor level.

**Subcommittee on Contracting and Workforce
Hearing on February 9, 2012
Questions for the Record
Jeanne Hulit – SBA**

- 1. Please provide details on how the SBA Surety Bond program works and explain:**
a. The differences between the Prior Approval Program (PAP) and Preferred Program and why are bonds rejected under the PAP?

SBA Response:

There are two program components in the SBA Surety Bond Guarantee (SBG) Program—the Prior Approval Program and the Preferred Program. As the name suggests, an SBG under the Prior Approval Program requires SBA's prior approval before the SBA guarantees the bond. A bond issued under the Prior Approval Program provides an 80% or 90% SBA guarantee, depending on the contract size or the nature of the bonded contractor. The 90% guarantee applies to bonds on contracts valued \$100,000 or less; it also applies to bonds for small business contractors: (i) owned and controlled by a socially and economically disadvantaged individual, (ii) owned and controlled by a veteran or service disabled veteran, or (iii) qualified under SBA's HUBZone program. For all other contracts under the Prior Approval Program, the bond guarantee rate is 80%. Applications for bond guarantees under the Prior Approval Program may be declined under the regulations when, for example, the contractor is ineligible or lacks creditworthiness. In addition, under the Prior Approval Program, sureties submit claims for reimbursement for losses paid by the surety, and SBA conducts a full review before payment of the claim.

In SBA's Preferred Surety Bond Program (PSB), surety companies are authorized to issue SBA-guaranteed bonds without the Agency's prior review and approval, and the bond guarantee rate under this program is 70%. In addition, PSB sureties submit claims for reimbursement for losses paid by the surety, and SBA pays these claims with limited review, but conducts a full review of the claims during an on-site audit that is conducted every 2 to 3 years for each surety.

- b. The program funding.**

SBA Response:

For FY 2012, SBA has \$1 billion in bond guarantee authority. There is a separate revolving fund within the Treasury that is used to pay a claim that arises when an SBA-guaranteed bond defaults. The fund is comprised of the contractor and surety fees, along with the recoveries SBA receives on any defaulting bonds, as well as funds appropriated by Congress from time to time.

As of February 2012, there is approximately \$58 million in reserve, which includes \$15 million for America's Recovery and Reinvestment Act of 2009 (ARRA) bonds and \$43 million for non-ARRA bonds. Loss studies are performed on a regular basis to ensure there is a sufficient reserve to pay potential claims.

In addition, the SBG Program's office operating budget for FY 2012 is approximately \$173,000, excluding salaries and benefits.

c. SBA measurements of success for the program – processing time, number of applicants, number of approved applicants, etc.

SBA Response:

SBA uses various indicators to assess program performance, activity, and trends. These include the number of bonds approved, the contract value of bonds approved, the number of jobs supported, and the number of small businesses assisted. The number of participating sureties and their individual performance are also reviewed. Claims paid, recoveries received, and related loss, default, and recovery rates are monitored, as well as application and claim processing cycle times.

d. The percentage of claims on the guarantees SBA accepts and if SBA can partially honor a guarantee or must it 100% honor or deny a claim.

SBA Response:

SBA honors the guarantee and reimburses surety companies for all allowable incurred costs. In FY 2011, for example, we received approximately \$5.9 million in claims in the Prior Approval Program and, after review, paid 99.9% of the claims, disallowing just \$8,294.

Under § 411(e)(3) of the Small Business Investment Act, SBA must deny full bond guarantee liability if any of the circumstances described in paragraphs (1) through (4) of that provision exist. Such full denial of liability has been rare over the past fifteen years. Under a temporary provision in ARRA, which expired on September 30, 2010, SBA was

given the discretion to deny liability in whole or in part, which was received positively by our industry partners.

2. Currently, SBA cannot guarantee bonds over \$2 million; however, for 2 years SBA was permitted to issue bonds up to \$5 million. Please explain whether the increase led to increased defaults, volume of bonds, or increased costs for the program.

SBA Response:

ARRA temporarily increased the contract ceiling from \$2 million to \$5 million for public and private contracts and subcontracts, and authorized SBA to guarantee bonds on Federal contracts up to \$10 million if the contracting officer certified that a bond guarantee in excess of \$5 million was needed. ARRA had a very positive impact on the SBG Program. During this period, 218 of the bonds guaranteed by SBA exceeded \$2 million, for a total contract amount of \$663 million. To date, there has been only one default on an ARRA bond. The number of bonds guaranteed in FY 2010 rose 36% above the previous year. This increase was accompanied by the admission of six new sureties to the program. After the expiration of ARRA, SBG Program activity increased by approximately 3% in FY 2011.

3. On a project like Army Corps of Engineers MATOC construction contracts, the contractor is required to furnish proof from a certified bonding company that they can obtain \$10,000,000 dollars worth of bonds each year. How does the SBA surety bond help a small business that wants to compete for this contract?

SBA Response:

SBA can guarantee bonds on contracts up to \$2 million in value. As a result, SBA cannot assist a small business in obtaining a bond on an individual MATOC or Task Order issued under a MATOC that exceeds \$2 million.

4. We have heard a number of complaints about the processing time. How long does it take for SBA to process a bond application? Does the processing time often impact the contractor's ability to compete on other jobs?

SBA Response:

In 1995, as part of the agency's consolidation effort, six of the ten Regional offices were closed and, in 2006, another two offices were closed. These closings resulted in increased processing times for bond guarantee applications and claims. Over the last several years, we have made a concerted effort to reduce processing times, including the implementation of an electronic application process and the addition of an application review function in

Headquarters to supplement the two area SBG offices. Cycle time for the review and approval of Prior Approval applications now averages approximately 2 days and does not interfere with a contractor's ability to compete for contracts. The cycle time for the review and approval of surety company claims has been reduced to approximately 8 days.

5. The SBA Bond Program is not an inexpensive program for agents to use. SBA charges the surety company 26% of the fee the surety charges the small business. SBA charges the small business .729% of the contract price for the bond guarantee. This can be a significant amount for small businesses. On the average they pay around \$19,000 for a \$500,000 contract.

a. Are there any plans to stabilize or decrease the fees?

b. What does SBA do with the fees?

SBA Response:

SBA charges both the small business and the surety company a fee for payment and performance bond guarantees. There is no fee for a bid bond guarantee. The contractor and surety fees collected are deposited in the revolving fund that is used to pay SBA's share of claims on defaulted bonds (See SBA Response to Question 1.b).

In the example above, the SBA contractor fee would be \$3,645 on a \$500,000 contract. The remaining amount paid by the contractor would be the premium charged by the surety. SBA does not set the surety premium. SBA has found that the fee charged by a surety company is very competitive with fees charged by the reinsurance industry. Furthermore, the fee charged to small businesses has not been found to be an impediment to small businesses obtaining bonds and competing for contracts.

At this time, there are no plans to change the surety bond guarantee fees; however, SBA monitors fees, recoveries, and claims on an ongoing basis to ensure appropriate funds management.

6. According to your testimony, SBA will be publishing a proposed rule that will adopt a streamlined application process for any bond guarantee on a contract valued up to \$250,000 to reduce paperwork requirements. How many bonds does SBA guarantee under \$250,000?

a. Was this a primary concern of small business or just a tactic that SBA chose to take to show some improvement in the program?

b. What is SBA planning to do to make real improvements to the program?

c. What are SBA's plans for helping small businesses on the contracts over \$250,000?

SBA Response:

In FY 2011, SBA guaranteed approximately 4,300 bonds under \$250,000. The new "Quick Application" process was a direct response to feedback that SBA heard from the surety industry. This process consolidates two forms into one and eliminates the requirement to submit two other forms, and represents a serious effort to streamline the application process.

The proposed Quick Bond Guarantee Application complements the current industry practice of using streamlined applications for smaller contract amounts and will help to address surety concerns about the amount of paperwork needed to apply for bond guarantees in the Prior Approval Program. And, while SBA believes this change is a positive step, we believe that other improvements may be made to make the program more attractive. To that end, we may pursue other structural changes to the Prior Approval and Preferred Programs as part of SBA's FY 2013 Legislative Package.

7. According to your testimony, SBA plans to make a number of changes to update, streamline, and simplify the surety bond regulations. What exactly are those changes and what is the schedule?

SBA Response:

In addition to the Quick Application process, we recently developed an automated tool to complement our electronic bond guarantee application that was implemented a few years ago. Now surety companies, their agents, and small businesses can upload a variety of underwriting documents and transmit them electronically to our field offices as opposed to incurring mail costs.

In addition, we added a Prior Approval application review function in our Headquarters operation to supplement the application review process in our two area SBA offices in Denver and Seattle. This change makes communication with the surety agents and application processing more efficient because SBA personnel and agents are located in the same geographical areas and time zones.

8. Numerous complaints about SBA's bonding program and its currency with commercial bonding practices have been received.

- a. Specifically, does SBA require notification of change orders in excess of what commercial sureties believe it is valuable to monitor?**
- b. Could this be the reason why more commercial sureties are not participating in SBA's program?**

c. How is SBA addressing this problem and what does SBA plan to do to appropriately align its practices with commercial practices?

SBA Response:

In the Prior Approval Program, the surety must notify SBA of any increases or decreases in the contract or bond amount that aggregate 25% or \$50,000, as soon as the surety acquires knowledge of the change. In addition, the surety must obtain SBA's prior written approval whenever the original bond amount increases as a result of a single change order of at least 25% or \$50,000. See 13 CFR 115.132(d)(1). Increases and decreases in the bond or contract amounts may result in changes in the fees payable to SBA, and the surety and principal may be entitled to a refund. Our industry partners have expressed concerns over these provisions. These and other requirements of 13 CFR Part 115 are currently being reviewed by SBA.