

Statement on the record

Mechanical Contractors Association of America

to the

Committee on Small Business

U.S. House of Representatives

For the hearing on

“Contracting and the Industrial Base”

February 12, 2015



The Mechanical Contractors Association of America (MCAA) serves the unique needs of approximately 2,500 firms involved in heating, air conditioning, refrigeration, plumbing, piping, and mechanical service. We do this by providing our members with high-quality educational materials and programs to help them attain the highest level of managerial and technical expertise. MCAA includes the Mechanical Service Contractors of America, the Plumbing Contractors of America, the Manufacturer/Supplier Council, the Mechanical Contracting Education and Research Foundation and the National Certified Pipe Welding Bureau.

The Mechanical Contractors Association of America

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February 12, 2015

The Honorable Steve Chabot, Chairman
House Small Business Committee
United States House of Representatives
Washington DC 20515

**Subject: MCAA's Statement for the Record on the hearing, *Contracting and the Industrial Base*,
House Small Business Committee, February 12, 2015**

Dear Chairman Chabot and Members of the Committee:

Please accept this letter and accompanying attachments as the formal MCAA statement for the record for the hearing today referenced above.

The Mechanical Contractors Association of America (MCAA) represents over 2,500 specialty construction businesses nationwide that operate across the full spectrum of mechanical construction industry, serving public and private sector clients nationwide. MCAA members are engaged in heavy industrial, institutional, public facility, commercial and residential new construction, service and maintenance, and energy efficiency retrofit projects of all types. MCAA members perform mechanical systems construction, plumbing and hvac system installation, and mechanical and plumbing service and maintenance projects of all types.

MCAA member companies perform those types of projects variously as either prime contractors with public and private project owners, or as subcontractors to primes contractors on various projects. MCAA member firms provide mechanical new construction and hvac/refrigeration system services and energy efficiency retrofit projects with a great many Federal Defense and Civilian agency facilities across the country. Moreover, MCAA's membership is comprised primarily of small business firms, but a substantial number also have progressed from small business status to larger annual dollar volume operations, in many cases thanks to various Small Business Administration programs. In all, MCAA member firms understand the broad purpose of the Small Business Committee's mission with respect to Federal construction contracting from both the prime contractor and subcontractor perspectives, and respectfully commends the committee for its work in recent years in enacting several constructive, good-government reforms in the Federal construction market.

The topics of this hearing emphasizing the importance of a sustainable and expanding small business contracting infrastructure to maintain the Nation's industrial base is consistent with that effort. MCAA notes that many of the issues on the docket for the February 12, 2015 hearing also are consistent with related goals to promote market equity for small business, while achieving direct Federal contracting procedural reforms that aid those goals and simultaneously Federal purchasing agency construction program effectiveness.



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MCAA fully supports further Committee action on all the topics on the hearing docket today as noted in the enumerated points below. In summary, MCAA's position is that Federal contracting procurement, prime and subcontractor selection, and contract administration reforms at all tiers that enhance the sustainability of small business competitiveness, also bolster the industrial base aims of the committee. Construction industry employers of all types, and especially those in the high-skill specialty contracting segment of the industry, train and provide the skilled worker base on the industry, which is among the largest and most technically adept workforce in the goods producing sector of the economy. Our sector of the industry leads the technical skill sector of the industry with employer and worker training in the latest building information modeling (BIM) design and production improvements, modular and off-site construction prefabrication facilities, along with other constant high technology developments, like high purity welding, automated welding and building automation control technology, and ever smaller facility energy efficiency technology improvements, such a small facility gas burning micro turbine combined heat and power systems. Our training programs themselves are models of high technology adaptation, with widespread use of distance learning tools, on-line technical courses, and use of on-line virtual training tools, where building facilities, tools and equipment are worked on virtually over the internet with technical interaction online.

1. **The Security in Bonding Act of 2013, H. R. 776** - MCAA joined with the great many other construction prime contractor and subcontractor groups in the 113th Congress in commending Representative Hanna for recognizing that the procedures under the Miller Act that permit individual surety bonds should be reformed to prevent loss to the Government and injury to subcontractors and suppliers in the event that a non-corporate surety bond is accepted and not backed by sufficient assets to meet the bond obligation. MCAA agrees with the broad industry consensus that the integrity of the surety bonds on a Federal project is key to taxpayer and agency protections and prevention of loss and competitive impairment for subcontractors and suppliers on those projects, who don't have the protections of mechanics' liens and must rely on the assets backing the bonds to prevent losses in the event of prime contractor defaults. This is a good-government reform that strengthens the Federal construction procurement process for all stakeholders, and in that way supports the sustainability of the small business infrastructure in building the skill base for the National industrial competitiveness resurgence in the goods producing economy.

Mechanical contractors are specialty trade contractors which often participate on federal construction projects at the subcontractor level. As a subcontractor, the mechanical contractor must rely on the solvency of the prime contractor for payment. Should the prime contractor become insolvent, the mechanical contractor's only payment remedy is the payment bond required of the prime contractor under the federal Miller Act, as the mechanical contractor cannot place a mechanics lien against public property and cannot sue the government as it has no direct contract with the contracting agency. It is precisely these reasons that Congress enacted the Miller Act in 1935 to provide payment protections to downstream entities furnishing labor and materials on federal construction projects. Currently, the federal Miller Act requires performance and payment bonds from



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prime contractors awarded construction contracts exceeding \$150,000, and payment security for contracts between \$30,000 and \$150,000.

Unfortunately, in recent decades--especially pronounced during the recent recession--these payment protections proved illusory in many instances where the payment bond was issued by an individual surety, rather than from a US Department of Treasury approved surety company, which undergoes a rigorous review and certification process to assess financial wherewithal and to gain approval to write bonds on federal contracts. Under the Federal Acquisition Regulation (FAR), individuals, natural persons, can act as a surety for a prime contractor seeking award of a federal construction contract without being licensed as an insurer in any state or territory of the US or reviewed by the US Department of the Treasury. Such persons merely have to pledge certain prescribed assets under the FAR, such as stocks or real property, and are not vetted with respect to criminal records, tax liens, or personal insolvency. Only the agency contracting officer, as part of his or her myriad duties, determines the acceptability of the individual surety and the pledged assets for each procurement. Not surprisingly, worthless bonds with non-existent assets have been accepted on numerous federal contracts, costing millions and millions of taxpayer dollars and jeopardizing the viability of many downstream businesses. This has been and continues to be a serious and vexing problem. I know that the Committee is aware of testimony by the National Association of Surety Bond Producers (NASBP) and the complementary position of The Surety and Fidelity Association of America in past Congresses that document such problems.

Mechanical contractors, like all subcontractors, rely on the efficacy of the payment bond for their payment remedy in case of nonpayment. Working on federal construction projects is made more attractive by virtue of the Miller Act requirement for payment bonds to be in place, and the federal government likely receives better pricing as a result of having payment bonds in place for subcontractors. However, under the current requirements allowing individual sureties to pledge a broad class of assets which are not placed in the direct care and custody of the federal government, worthless individual surety bonds will continue to be accepted. Such individual bonds subvert, if not, destroy the Miller Act payment remedies given to subcontractors, undermining our confidence that our payment bond remedy is real and available in the case of bonds issued by individual sureties.

One worthless payment bond can spell financial disaster for the many businesses acting as subcontractors on any given federal construction project. MCAA urges the Committee to act to close this loophole that permits chicanery, gamesmanship, and fraud at the expense of taxpayers and construction businesses. MCAA supports the reintroduction and support in this Congress of such measures as H.R. 3534 in the 112th Congress and H.R. 776 in the 113th Congress. Such measures enjoy the broad support of prime contractors and subcontractors alike. The legitimate use of individual surety will be bolstered and fraud and abuse by questionable providers will be substantially curtailed.



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2. **Two-step design/build procurement methods** - MCAA also commends the Committee for continuing to look into ways to address the growing use of design/build procurement, and to continually monitor the growing use of alternative contractor selection methods to make sure that small businesses and government agencies are both being well served by procurement procedures in the interests of the agency programs overall and small business and the taxpayers in general. MCAA supports the Committee's proposal to make sure that agencies adhere to the two-step design/build procedures, and short list no more than 5 design/build teams after the initial responses to the request for qualifications, unless there is a specific justification for short-listing more teams, as proposed in H.R. 2750 in the 113th Congress. The significant shift of direct Federal construction procurement from low-bid selection (generally now approximately only 10% of dollar volume) to negotiated selection procedures – design/build chief among those (now fully 90% of overall dollar volume – perhaps more for some agencies) should be a continual subject for examination for the committee's procurement jurisdiction. Also, MCAA would encourage the committee to look into whether and how the design build reform in Far Part 15 selection procedures should specifically apply to both low-price/technically-acceptable (LPTA) award methods and multiple award task order contracting (MATOC) as well. It may be that in some cases, agencies are turning back from full scale design-build procedures, to a streamlined LPTA procedure- in some cases to address agency acquisition/procurement workforce issues. MCAA would support reintroduction of H.R. 2750 to expand that consideration and in that way improve the sustainability of the small business industrial base.

3. **Ban internet reverse auctions for construction prime contractor low-bid selection** - MCAA commends the Committee for its persistence in attempting to enact the full U.S. Army Corps of Engineers' recommendation, after the USACE pilot study conducted in 2004, that agencies should be foreclosed altogether from using internet reverse auctions for direct Federal construction prime contractor low-bid selection decisions. The USACE pilot study was called for in the regular order of Congressional business more than several years ago. Its pilot study was comprehensive, and detailed. USACE's conclusion was unambiguous – internet reverse auctions for direct Federal prime contractor low-bid selection are not advantageous to the government. The virtually unanimous industry view at the time was that the USACE was 100% correct on the issue. There is nothing but potential problems in the use of low-bid internet bid shopping selection methods for prime contracts. That process forsakes all the business discipline of the sealed, low-bid process – and thereby transfers a large bundle of project risk and jeopardy that devolves right down to problems for the agency project, its mission, and the taxpayers.

Nothing has changed since then to rebut the USACE's categorical opposition to the practice. Yet since then, still some few agencies attempt occasionally to use the process by categorizing some small scope construction projects as commodity procurement.



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Most recently, the joint Small Business/Veterans Affairs Committee hearing on construction projects last year on the occasion of a negative General Accountability Office (GAO-14-108, 2013) report on the inapt use of reverse auctions by the VA turned up several such efforts by the VA in recent years. Similarly, occasionally GSA has undertaken initiatives to define some types of construction projects (roofing projects, and building equipment replacements) as commodity contracts and apply commodity purchasing techniques to those projects.

MCAA fully support reintroduction of the Commonsense Construction Act (H.R. 2751 in the 113th Congress), as MCAA fully supports the USACE work product that duly noted after comprehensive study, there are no provable project cost advantages from reverse auctions (a form of open electronic bid shopping of the prime contractor's initial bid), exposing the agency to significant project drawbacks from an exposed bid shopping system that forfeits all the beneficial discipline of the sealed, low- bid system. Imprudent bidding is engendered by open bid shopping at the prime contract level, and the agency and prime contractors and subcontractors alike, small business and otherwise, are detrimentally exposed to predatory prime bidders that would buy the job too low in an internet reverse auction, and then make up for the lack of discipline in poor project performance, disputes, and claims.

Virtually all construction prime contract and subcontractor groups join in supporting the USACE and now the Committee's recurrent proposal to ban internet reverse auctions for construction low-bid prime contractor selection procedures. MCAA also would strongly suggest that H.R. 2751 be redrafted to also extend to FAR Part 15 price-only selection procedures in use under LPTA and MATOC awards as well, in addition to FAR Part 14 (not sealed), low-bid award procedures. Attached is MCAA's policy statement against low bid auction procedures, which is typical of many industry group statements. (Attachment 1).

4. **Use of Small Business in Joint Venture and Team Projects** - MCAA would support consideration of reforms the committee would propose to remove barriers to past performance and financial evaluation of small business joint venture and project team businesses that may be excluded from evaluation in favor of only prime contract past performance evaluations and financial resources evaluations under current procedures. To the extent necessary, such proposed reforms would open up opportunities for greater use of small business, serving the interest of maintaining the industrial base those firms supply. Likewise, this broader type of business review for all team members is in line with MCAA policy promoting greater screening of all primes and subcontractors in the contract award process. If all project team or joint venture firms are named and evaluated at the inception of award, then the full credit of past performance records and financial stability can be known and evaluated – strong performance recognized and encouraged, and past problem projects disclosed and evaluated too early enough to avoid predictable problems.



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5. ***The non-manufacturer rule*** - MCAA also supports the Committee's potential consideration of the misapplication of the non-manufacturer rule (NMR) by the courts, and the impediments that misapplication may present for small business utilization in the future. If the courts and agencies are to apply the non-manufacturer rule for goods purchasing to construction services contracts, the unintended consequences could be very great. Under the non-manufacturer rules, small business contract awards for commodities restrict pass through of goods manufactured by large businesses through the small business firm. That rule cannot readily be transferred to small business construction firms, as many of the equipment and systems provided for construction projects are not the product of small business manufacturing. In the mechanical industry for example, major heating, ventilating, air conditioning and refrigeration systems, and large energy efficiency systems such as combined heat and power micro turbines, are not made by domestic small businesses. Yet, the small business firms that purchase and install those systems do so as legitimate small business construction firms. MCAA commends the Committee for looking for ways to stem this misapplication of the non-manufacturer rule.

Respectfully submitted,

A handwritten signature in black ink that reads "John McNerney". The signature is written in a cursive, flowing style.

John McNerney, General Counsel MCAA

Attachments:

1. MCAA ***Statement on the Use of Internet Reverse Auctions for Construction Services***

MCAA Statement on the Use of Internet Reverse Auctions for Construction Services

MCAA considers the use of Internet reverse auctions for procurement of construction services to be *problematic for owners and contractors alike*.

While most applications of various e-commerce and Internet use (project websites, for example) have demonstrated or hold great promise for productivity and service improvements for owners and the industry at large, the same cannot be said for Internet reverse auctions. MCAA considers them to be little more than a form of *electronic bid shopping*; that is, disclosing the proprietary bid price of a competitor to all others for the purpose of obtaining even lower bids.

While reverse auctions may be judged appropriate by some owners for certain well defined projects on a case-by-case basis, an across-the-board policy dictating reverse auction, price-only selection for all projects would be just as short sighted as dictating a single type of project delivery system for projects of all types.

MCAA, along with the industry overall, long ago recognized the long-term detrimental impact of an across-the-board policy of low-bid, price-only selection criteria, and the bid shopping and chopping practices that are inherent in that system and undermine project success, such as: fragmented scopes of work and scope disputes, unnecessary changes and inordinate delays, and overhead waste relating to defensive contract administration, claims, disputes and lawsuits.

In fact, many of the innovations in construction procurement, contracting and project administration over the past 20 years have been in direct response to the inefficiencies that stem from low-bid, price-only selection criteria. Those innovations include value-based selection criteria, careful past performance evaluations, prequalification screening of competitors, project partnering, integrated project contracting and delivery systems, design-build services delivery, and other positive contract administration procedures, including dispute avoidance mechanisms and measures to reduce project dispute overhead costs. Overall, these developments have represented a better investment in overall project quality and life-cycle cost effectiveness.

Unfortunately, Internet reverse auctions can be seen as a way to adapt new technology to return to many of the problems of the past and give back the project efficiency gains that have resulted from innovative, value-added contracting procedures. Nevertheless, given recent experience with reverse auctions, MCAA members have encountered certain approaches that tend to ameliorate the more difficult aspects of the process as discussed below.

> Well-defined scope of work - Reverse auctions are least likely to lead to problem jobs in those cases where the owner has firm, detailed design drawings and specifications. Recent studies strongly indicate that project planning up front is the best predictor of project success and problem avoidance.

> Use of best-value prequalification criteria - Best-value prequalification criteria should be rigorously applied. The criteria should include demonstrated superior past performance related to project performance overall, including cost and schedule delivery, project safety experience, workforce training and development investments, and project management and site supervision expertise relating to equipment purchasing and other aspects of contract administration.

> Transparency of auction procedures - The reverse auction procedures should provide maximum transparency in the interest of fairness for all competitors. The identity of all participants should be disclosed, as well as the dollar amount and ranking of all bids. Similarly, the owner should disclose the existence and amount of any reserved price above which the project would not be let. Just as laws pertaining to the auctions of goods are designed to protect fairness in the process and prevent fraud and abuse, the owner and Internet service provider for reverse auctions of construction contracts should make sure that all competitors are extended the same privileges under the auction rules.

> Provide adequate procedures for redress of errors - The auction procedures should provide careful safeguards against both imprudent and administrative mistakes in bidding, as overall project success is strongly compromised by mistakes in selection decisions. Even at this early stage, it is widely recognized that the reverse auction process often tempts hasty and imprudent bidding given the tight time frame and competitive context of the auction procedure. The industry recognizes that selection based on competitive frenzy as opposed to more discerning judgment is a high risk factor for project success. Bid decrements and the time intervals for bid adjustments should be appropriate for the scope and size of the project. Clerical mistakes also should be excused in the auction process in the manner of treatment of those mistakes in the sealed bidding context. Overall the owner should not design the process as though construction service auctions can be conducted in the same way as commodities procurement.

> Provide adequate safeguards against other abuses - The reverse auction procedures should also contain adequate safeguards against fraud and abuse, including express warranties against fictitious ("phantom bidders") bidders and other conditions that would constitute fraud in the inducement of the contract award. Moreover, any procedure for post-bid negotiated awards should be disclosed up front so competitors can fairly judge whether they can afford to compete. Similarly, if post-bid price increases are to be permitted, that too should be disclosed up front.

> Policy reservations - Notwithstanding adherence to the suggestions listed above, MCAA member experience suggests that reverse auctions remain a relatively new, untested and unproven method to actually lower construction costs without compromising project success.

MCAA contractor experience with Internet reverse auctions suggests that the last bid in a reverse auction is not always the lowest and best price that may have been submitted even under sealed bidding procedures. Owners should be aware that a comparison of the opening bid with the last bid is not a valid indicator of actual cost savings on the project. Moreover, while open competition is good policy generally, even with careful prequalification screening, the auction process prompts fast and furious competitive judgments more than prudent decision-making. Negative experiences could significantly shrink the pool of willing competitors, and deliver negative project outcomes.

In conclusion, early experience suggests that the risks of mistakes, misjudgments and the added costs of Internet services may well in many cases outweigh the *perceived costs savings* realized through the use of reverse auctions.

MCAA will continue to monitor experience with reverse auctions for a continuing factual assessment of their costs and benefits and effect on project outcomes.

Footnote - This statement does *not* address the many ways that public and private contracting practices vary with respect to contractor selection rules and procedures generally and reverse auctions in particular. In the main, Federal, state, and local open competition/sealed bidding rules prohibit reverse auctions for construction. The Federal procurement policy is to continue to use sealed bidding/competitive negotiations without price disclosure for construction services, even though one agency has Congressional authorization to test pilot reverse auctions. Another agency is attempting to categorize some construction/repair/alteration projects as "commercial items" to avoid construction procurement rules. At the state level, a growing number of states are amending procurement laws to permit reverse auctions for commodities, but are careful to rule out reverse auctions for construction services.

Approved by the MCAA Board of Directors, February 28, 2004