**Statement of**
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on behalf of the

**Construction Industry Procurement Coalition**

to the

**U.S. House of Representatives**

**Committee on Small Business**
**Subcommittee on Contracting and Workforce**
**Subcommittee on Investigations, Oversight, and Regulations**

for a hearing on

**"All Work and No Pay: Change Orders Delayed for Small Construction Contractors"**

**May 25, 2017**

# Statement of E. Colette Nelson
# Construction Industry Procurement Coalition

On behalf of the Construction Industry Procurement Coalition, I'd like to thank the Committee on Small Business, its members and staff for taking seriously construction industry concerns about processing and paying for change orders on federal construction projects. The Coalition is a 14-member group of trade associations representing construction design professionals, prime contractors, specialty trade contractors, subcontractors, suppliers, sureties and surety bond producers. For those of you who have worked with the construction industry on other issues, you know that all too frequently it is difficult for us to agree on almost anything. Thus, I am pleased to report to you that the construction industry is united on both the problem and possible solutions to the problem of slow approval and payment of change orders on federal construction projects.

Since the United States government began purchasing construction services and materials – that is, since its inception – there have been disagreements between the government and its suppliers about payment. Indeed, even before the Declaration of Independence was signed, the states issued "war bonds" promising to pay the Continental Army's suppliers.

In the construction industry, even in the private sector, we have more than our share of payment challenges. While George Washington was in charge of buying for the war effort, one of Virginia's other founding fathers, Thomas Jefferson, introduced the concept of a mechanics lien into the New World's statutory system. That is, since a construction contractor's work is incorporated into the real property and cannot easily be removed, the contractor who has not been paid may reduce its financial risk by acquiring an interest in that real property in the form of a mechanics lien. Eventually, the courts ruled that a contractor cannot lien public property – the king's land. Congress responded by passing the Heard Act in 1894; this law required a prime contractor to provide a single performance and payment bond to protect the government and subcontractors, respectively. In 1935, Congress replaced the Heard Act with the Miller Act, which requires a federal prime construction contractor to post bonds guaranteeing both the performance of their contractual duties and the payment of their subcontractors and material suppliers.

By the 1980's, the construction industry was again reporting challenges with getting paid on federal projects. Congress responded by enacting the Prompt Payment Act of 1982, and, when problems persisted, the Prompt Payment Act Amendments of 1988. The law established very specific time frames for the government to pay its construction prime contractors for work performed and for those prime contractors to pay their subcontractors and so on through the construction tiers. These laws have done an excellent job in assuring prompt payment on federal construction for progress payments and final payment – but, unfortunately, not for requests for equitable adjustment, more commonly called change orders.

I review this history both to show the insidious nature of payment problems on federal construction and to demonstrate Congress's willingness to address them. The legislative history also demonstrates that while the current statutory structure helps assure contractor payment, it also protects the federal government. For example, when a federal prime contractor submits an invoice for payment, it must include the following certification:

> "I hereby certify, to the best of my knowledge and belief, that—
> (1) The amounts requested are only for performance in accordance with the specifications, terms, and conditions of the contract;
> (2) All payments due to subcontractors and suppliers from previous payments received under the contract have been made, and timely payments will be made from the proceeds of the payment covered by this certification, in accordance with subcontract agreements and the requirements of Chapter 39 of Title 31, United States Code;
> (3) This request for progress payments does not include any amounts which the prime contractor intends to withhold or retain from a subcontractor or supplier in accordance with the terms and conditions of the subcontract; and
> (4) This certification is not to be construed as final acceptance of a subcontractor's performance."

Penalties for a contractor who falsely certifies to the government are between $10,781.40 and $21,562.80 per claim, plus three times the amount of damages that the federal government sustains because of the false claim—certainly a deterrent to a false certification.

As other witnesses will testify, existing payment protections for contractors on federal construction are not working when it comes to changes, more commonly referred to as change orders or requests for equitable adjustment. A change order, in its simplest form, is an agreement to affect a change to the already executed contract. Often, it is necessitated by added, deleted or simply changed work from the plans and specifications already bid and agreed upon. While a change order typically adds value to the contract in exchange for the changed scope, it also can delete funds, change work without affecting price, and add or subtract time to completion of the work. The change order process is complex, and involves the construction owner, the prime contractor and the subcontractor tasked with the change.

In federal construction, the most easily identifiable change orders come from the federal government in what is commonly called a directed change–a "written order designated or indicated to be a change order, make changes in the work within the general scope of the contract." This includes changes in the specifications, in the method or manner of performance, in the government-furnished property or services, or acceleration of the work.

The Federal Acquisition Regulation requires a contractor to submit a request for payment for the increased cost of performing the revised contract within a fairly tight

time frame—within 30 days after receipt of the written change order or notice. The FAR provides an additional incentive for a contractor to act expeditiously by stating that "except for an adjustment based on defective specifications," no adjustment in cost can made for any costs incurred by the contractor "more than 20 days before the Contractor gives written notice as required." That means during a 20 to 30 day window, the prime contractor must consult with its subcontractors, and put together a cost estimate that will stand up to the federal government's strict pricing and audit requirements.

Yet the federal government's rules establish no minimum requirements on when the government itself must review and approve the contractor's request for equitable adjustment. Instead, the FAR requires a contracting officer to "negotiate equitable adjustments from change orders in the shortest practicable time" with no further specificity. Thus, while the prime contractor and its subcontractors must act swiftly to price their increased work, all the while performing the work at the direction of the government, federal agencies apparently have interpreted "shortest practicable time" to mean a time that is administratively convenient for them.

As an example, let's look at the stated policies and procedures of just one federal construction agency, the U.S. Army Corps of Engineers (USACE). Again, nothing in the FAR, the Department of Defense FAR Supplement (DFAR), the U.S. Army Supplement to the DFAR (AFARS) or the USACE Acquisition Instruction (UCI) [Version 3; 1Nov14) specifies time periods during which a contracting officer is required to act on a contractor's REA, on the contractor's request for additional funding or a schedule adjustment to accommodate the government's unilateral change order. In addition, the UCI specifies that any contract modification in excess of the Simplified Acquisition Threshold ($150,000) requires a formal Independent Government Cost Estimate (IGE), pursuant to USACE Procurement Instruction Letter (PIL) 2012-03-R1 (Requirements for Development, Review and Approval of the Independent Government Estimates (IGE)).

Further, under USACE procedures, a contracting officer is authorized to bundle the contractor's requests for written change orders "for ease of administrative processing," which is exclusively beneficial to the government. The USACE contracting officers routinely defer consideration of all of a contractor's REAs to the end of the construction project when they can be "resolved as an omnibus settlement." Again, this is solely to the benefit of the government, since the contractor and all of the subcontractors and suppliers are funding the performance of the multiple unilateral change orders issued by the government during the total duration of contract performance. Most likely, such unconscionable deferral of action by the government flows from the desire to conduct only one IGE and the necessity to make certain that adequate funding is available to fund the "omnibus settlement."

The Construction Industry Procurement Coalition hereby petitions this Committee and others in Congress to take action to provide relief to prime construction contractors and subcontractors from the slow processing and payment of change orders on federal construction. The Coalition has identified and supports several legislative solutions to

the problems experienced by construction contractors and subcontractors with respect to change orders.

**Provide Notice of Agency Policy and Procedures on Change Orders**
The CIPC recommends that Congress require federal agencies to advise competing offerors about the agencies' policies with respect to the time for processing and paying for change orders, so that they make appropriate business judgments prior to submission of bids or offers.

For example, if this proposal were in place, the USACE would have to tell its prospective bidders that it has the right to "bundle" the processing of change orders until the end of the project. By obtaining this information in advance, prospective offerors could factor into their offers to the federal government the risk and resulting cost of delayed payment for change orders. On projects with a short time frame, businesses simply may increase their bids to take into account the cost of money. On projects with a longer time frame, many businesses, particularly small and emerging firms, may choose not to participate.

The proposed "Small Business Know-Before-You-Bid Construction Transparency Act" (H.R. 2350) takes one approach to this notice requirement by requiring a federal agency to actually report information about the agency's past performance in processing requests for equitable adjustment in its IFBs and RFPs. The Coalition supports H.R. 2350.

**Establish Deadlines for Agency Response to an REA**
The CIPC recommends that Congress specify deadlines for the issuance of a written change order and a response to the contractor's proposal for modification to the construction contract schedule and additional funding to cover the contractor's estimate of the additional costs associated with performing the work flowing from a unilateral change order. As noted previously, the FAR establishes deadlines for a contractor to submit an REA, but establishes no such deadlines for agency action.

Such a directive, for example, could require that a contracting officer issue a final decision regarding an REA submitted by a small business within 14 days with respect to a request in the amount of $1 million or less and 28 days with respect to a request in an amount more than $1 million.

**Require Provisional Payment of 50 Percent of an REA**
The CIPC recommends that Congress establish a requirement that when an agency issues a unilateral change order, that the contracting officer provisionally authorize the payment of 50 percent of the additional funds requested by the contractor to cover the government's unilateral change order, without an IGE.

Such provisional payment is considered a best practice in the private construction market. For example, model documents published by ConsensusDocs—a coalition of

more than 40 construction owner, design professional, contractor, subcontractor and surety organizations—state in their changes clause:

> "8.2.2 The Parties shall negotiate expeditiously and in good faith for appropriate adjustments, as applicable, to the Contract Price or Contract Time arising out of an Interim Directive. As the directed Work is performed, Constructor shall submit its costs for such Work with its application for payment beginning with the next application for payment within thirty (30) Days of the issuance of the Interim Directive. If there is a dispute as to the cost to Owner, Owner shall pay Constructor fifty percent (50%) of its actual (incurred or committed) cost to perform such Work. In such event, the Parties reserve their rights as to the disputed amount, subject to the requirements of ARTICLE 12 [Dispute Resolution and Mitigation]. Owner's payment does not prejudice its right to be reimbursed should it be determined that the disputed work was within the scope of the Work. Constructor's receipt of payment for the disputed work does not prejudice its right to receive full payment for the disputed work should it be determined that the disputed work is not within the scope of the Work. Undisputed amounts may be included in applications for payment and shall be paid by Owner in accordance with this Agreement."
> *Excerpt from ConsensusDocs Form 200, Standard Agreement and General Conditions Between Owner and Constructor (Lump Sum) (2017).*

The CIPC notes that, under the Prompt Payment Act Amendments of 1988, such payment to a prime contractor would be required to flow through to subcontractors for their performance on such change order work.

**Require Regular Reports on the Status of REAs**

The CIPC recommends that Congress require federal agencies to regularly report to their prime contractors, actions taken on requests for equitable adjustment. Specifically, CIPC suggests that a federal agency include with each progress payment to a prime contractor, information on the status of each REA submitted by the contractor. Contractors, particularly small and emerging firms, must plan and carefully manage their cash flow. A status report on its REAs would alert a contractor whether or when it can expect payment for change order work performed. Alternatively, a federal agency could post such information on an appropriate government Web site.

A requirement for regular status reports on REA would complement other payment transparency provisions supported by the CIPC. This includes language included in H.R. 2350, which would require a federal agency to post on a Web site each payment made to the prime contractor, including the date of payment and the amount paid, specifying any amounts withheld from the amount requested by the prime contractor and a general explanation of why an amount was withheld. This information would allow a subcontractor or supplier to determine when its payment is due, without resorting to contacting directly the already harried federal contracting officer or the prime contractor. Further, the prime contractor would benefit from having a clear statement of why its

federal customer did not issue full payment so that it can more expeditiously address and correct any problems.

The CIPC also supports the provision in H.R. 2350, which would require a federal agency to post on a Web site a copy of any payment bond provided for the contract and any modification to such bond required by the agency. This information will allow a subcontractor or supplier to obtain a copy of the payment bond without resorting to contacting directly the contracting officer or the prime contractor. Subcontractors and suppliers need a copy of the bond to determine its existence and validity and where required notices must be provided.

Thank you again for inviting the Construction Industry Procurement Coalition to testify before the committee today. I look forward to answering any questions you may have now or subsequent to the hearing.

**Appendix A**
**Construction Industry Procurement Coalition**

- American Council of Engineering Companies
- American Institute of Architects
- American Society of Civil Engineers
- American Subcontractors Association
- Associated General Contractors of America
- Construction Management Association of America
- Council on Federal Procurement of Architectural and Engineering Services
- Independent Electrical Contractors
- Management Association for Private Photogrammetric Surveyors
- National Association of Surety Bond Producers
- National Electrical Contractors Association
- National Society of Professional Surveyors
- Sheet Metal and Air Conditioning Contractors National Association
- Surety and Fidelity Association of America