

Statement of
Mr. Anthony Zelenka of Bertucci Contracting Corporation
on behalf of
The Associated General Contractors of America
to the
Committee on Small Business
U.S. House of Representatives

For a hearing on
The Impact of Emerging Procurement Methods on Small Business

March 6, 2008



Building Your Quality of Life

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. Anthony Zelenka
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Thank you Chairwoman Velazquez, Ranking Member Chabot and the distinguished members of the Committee for this opportunity to testify on AGC's documented concerns and experience with the procurement method known as "Reverse Auctions."

I am Tony Zelenka, the President of Bertucci Contracting Corporation and Chairman of the Corps of Engineers Committee for the Associated General Contractors of America (AGC). My company is a small business that performs levee and coastal restoration work across the Gulf Coast. I was born and raised in New Orleans, and I have over 20 years of experience in the construction industry. My family's firm traces its history back to 1875, when my great-great grandfather founded the company in New Orleans.

The AGC Experience

AGC strongly supports full and open competition for the many contracts necessary to construct improvements to real property. This includes competition among general contractors, specialty contractors, suppliers and service providers. Over the years, it has been established that such competition energizes and improves the construction industry to the benefit of the industry and the nation as a whole. As the Committee considers the changing Federal procurement landscape, AGC offers the following points for consideration during your evaluation of reverse auctions.

Reverse Auctions Do Not Provide Benefits Comparable to Currently Recognized Selection Procedures for Construction Contractors

Vendors promoting reverse auctions have yet to present persuasive evidence that reverse auctions will generate savings in the procurement of construction or will provide benefits of "best value" comparable to currently recognized selection procedures for construction contractors, which have been carefully and specifically tailored for all types of construction.

Manufactured goods are subject to little or no variability or change in manufacture or application. Construction projects, on the other hand, are inherently variable. Each is subject to the unique demands of the project, such as the needs, requirements, personnel and budgetary criteria of the owner, site conditions, design features and parameters, and the composition of the project team. Federal procurement laws recognize that construction stands apart from commodities or manufactured goods.

AGC contends that vendors suggest reverse auctions for construction services misuses a procurement process originally designed for commodities. It ignores the unique nature of construction. Construction contractors, specialty contractors, subcontractors and suppliers offer and provide a mix of services, materials and systems. They do not "manufacture" buildings,

highways, or other facilities. In fact, the construction process is fundamentally different from the manufacturing process.

This distinction was reiterated in a July 2003 memorandum from the Office of Federal Procurement Policy (OFPP), which states that "...construction projects and complex alteration and repair, in particular, involve a high degree of variability, including innumerable combinations of site requirements, weather and physical conditions, labor availability, and schedules." This memorandum was sent to all federal procurement executives, advising them not to treat construction as a commodity for government procurement purposes.

Reverse Auctions Do Not Guarantee Lowest Price

In the context of construction, AGC believes that most of the claims of savings are unproven and that reverse auction processes may not lower the ultimate cost of construction. For example, "winning" bids may simply be an established increment below the second lowest bid not the lowest responsible and responsive price. Moreover, in reverse auctions, each bidder recognizes that he or she will have the option to provide successive bids as the auction progresses. As a result, a bidder has little incentive to offer its best price and subsequently may never offer its lowest price. In addition, savings from reverse auctions can be one time occurrences. Some reports show savings realized by an owner in the first reverse auction are significantly reduced in subsequent reverse auction events.

Reverse Auctions May Encourage Imprudent Bidding

Reverse auctions create an environment in which bid discipline is critical yet difficult to maintain. The competitors have to deal with multiple rounds of bidding, all in quick succession. The process may move too quickly for competitors to accurately reassess either their costs or the way they would actually do the work. If competitors act rashly and bid imprudently, the results may be detrimental to everyone, including the owner. There are even reported cases in which buyers actually step in to keep an overzealous supplier from obtaining an order that would potentially jeopardized the business viability of the supplier. Absent such steps, imprudent bidding may lead to performance and financial problems for owners and successful bidders, which may have the effect of increasing the ultimate cost of construction as well as the cost of operating and maintaining the structure.

Negotiated Procurements Allow Thorough Evaluation of Value

Where price is not the sole determinant, owners increasingly have utilized processes focused on negotiation to expand communication between the owner and prospective contractors for the purpose of discussing selection criteria such as costs, past performance and unique needs. These processes recognize the value and quality of project relationships and other factors that promote greater collaboration among the owner and project team members. These processes also consider quality, system performance, time to complete and overall value that can, in fact, outweigh the lowest price to arrive at the best value for the owner. Such an approach offers both the owner and contractor the opportunity to discuss, to clarify performance requirements of the project.

On the other hand, reverse auctions do not promote communication between the owner and bidders. Rather, they promote a dynamic in which bidders repeatedly attempt to best each other's prices. In fact, current studies of reverse auctions between buyers and suppliers have found that reverse auctions often have a deleterious effect on the relationship between buyer and seller. Moreover, non-price factors of consequence to the owner, such as quality of relationship, past performance, and unique needs, are deemphasized in the auction. As a result, reverse auctions do not offer owners a good way to evaluate non-price factors.

Sealed Bidding Assures that the Successful Bidder is Responsive and Responsible

Where price is the sole determinant, the sealed bid procurement process was established to ensure integrity in the award of construction contracts. Each bid is evaluated through the use of objective criteria that measure responsiveness of the bid to the owner's articulated requirements and the responsibility of the bidder. In this manner, sealed bidding ensures fairness and value for the owner. On the other hand, reverse auctions ignore this tradition. The pressure and pace of the auction environment removes any assurance that initial and subsequent bids are responsive and material to the owner's articulated requirements. These auctions expose owners to the real possibility that they may award contracts to what would otherwise be non-responsive bidders. In addition, reverse auctions ignore the protections of the sealed bid procurement's laws, regulations and years of precedent that address these critical factors and ensure the integrity of the process.

Reverse Auctions may Contravene Federal Procurement Laws and Certain State Laws

Federal procurement laws do not specifically address the use of reverse bid auctions to procure construction. The Federal Acquisition Regulation (FAR) and current procurement statutes, however, do reflect a clear policy of not disclosing contractor price information. Price disclosure is often a distinguishing feature of reverse auction processes. Given the restrictions on contractor price disclosure in the U.S. Code and the FAR, it is unclear that any authority exists for the federal government to conduct reverse auctions on fixed-price type contracts or that current law can be interpreted to permit the practice of reverse auctions by the federal agencies. In addition, some states, such as Pennsylvania and Kansas, have enacted statutes that prohibit procurement of construction through reverse auctions.

The Government Experience

AGC strongly recommends that the Committee encourage OMB, OFPP and the FAR Council to closely examine the finding of a Congressionally-mandated reverse auction pilot program the Army Corps of Engineers (USACE) issued July 26, 2004. The findings of the report clearly found that reverse auctions were an inappropriate tool to procure construction and construction-related services. The report further stated that reverse auctions fail to realize any additional savings over the sealed bid process.

In its final determinations, USACE found that the acquisition of construction services cannot and should not be equated with commodities for the following reasons:

- Within the operational parameters of Department of Defense contracting regulations, the dynamics are much too diverse between [construction services and commodities];
- Virtually all of the USACE construction services...are one-of-a-kind projects under one-of-a-kind conditions with numerous and consistent variables for cost and no-cost factors;
- Additionally, the Office of Federal Procurement Policy (OFPP) has recently supported this very significant fact. In a July, 2003 memorandum [recognizing] that construction services cannot be equated to commodities or manufactured goods when she acknowledged, “new construction projects and complex alterations and repairs...involve a high degree of variability.”

The USACE report stated that there was no proof that reverse auctions provide any significant or marginal edge in savings over the sealed bid process for construction services for the following reasons:

- There was no proof that a consistent, reliable and valid measurement method for projecting savings could be established from reverse auctioning;
- Absent any specific price history for an identical project under identical conditions, there is no practical way to measure or compare any projected savings by reverse auctions over sealed bidding; and,
- There is no proof reverse auctions provided any significant or marginal savings in comparison to the government estimate.

Concluding Remarks

To sum up, AGC believes that where reverse auctions for construction have been studied, they have failed to provide savings. They are an unproven method for selection of construction contractors, specialty contractors, subcontractors, and suppliers. At best, reverse auctions raise significant issues for owners and construction team members for the following reasons:

- Reverse auctions do not guarantee the lowest price.
- Reverse auctions may encourage imprudent bidding.
- Negotiated procurements allow thorough evaluation of value.
- Sealed bidding assures that the successful bidder is responsive and responsible.
- Reverse auctions may contravene federal procurement laws and certain state laws.

We have taken the liberty providing the Committee with the AGC White Paper, along with a copy of the OFPP July 3, 2003 memo, and a copy of the Executive Summary from the Corps of Engineers Report on Reverse Auctions, for the record.

Thank you for this opportunity to comment. I look forward to working with the Committee and would be happy to answer any questions.