SPECIAL SECTION: CONSTRUCTION LAW

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Supporting Small Businesses

Diversity Programs Help MWBEs Stay on Top

ALSO: PURSUING FEDERAL CONTRACTS

Pursuing Federal Government Construction Contracts

BY REGGIE JONES

With the significant downturn in the economy and resulting slowdown in the commercial construction market, many contractors are strongly considering getting involved in federal construction or expanding the portion of their business dedicated to federal contracting.

The federal government historically has been the world's largest consumer of construction services, and the risk associated with nonpayment is low. Further, the federal government's demand for services has increased with the enactment of The American Recovery and Reinvestment Act of 2009 (ARRA). The stimulus bill appropriated $787 billion, of which $134 billion is dedicated to construction spending as directed by federal agencies through grants to states and loans to support local infrastructure projects.

Before contractors get involved, they must understand the hidden costs and risks associated with government contracting. They must assemble the right team of people to find appropriate projects; identify how to get involved (joint venture, teaming agreement, mentor-protégé program); respond to requirements contained in RFPs; implement the necessary internal systems for federal compliance and ethics; and communicate effectively with the contracting

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officer, technical representative, inspector and other government project personnel.

GETTING STARTED IN FEDERAL CONSTRUCTION

To get started, contractors must first register with the Central Contractor Registration (CCR) and Online Representations & Certifications Application (ORCA), both of which can be found at the Business Partner Network at www.bpn.gov. To register, contractors need their company's Data Universal Numbering System (DUNS) number, federal tax ID number and electronic funds transfer information. A joint venture must register separately from the partner business. If contractors want to pursue ARRA projects, they also must register at www.federalreporting.gov.

Contractors can track where ARRA money is being spent in their respective markets on www.recovery.gov.

Contractors can track where ARRA money is being spent in their respective markets on www.recovery.gov. This website captures the recipient name, award number, agency name and award amount. Most states are tracking spending on their own websites, such as Virginia's www.stimulus.virginia.gov. It does not, however, provide information on open RFPs. To find federal contracting opportunities, contractors should regularly monitor the Federal Business Opportunities website at www.fedbizopps.gov, as well as state procurement sites.

INCREASING FEDERAL CONTRACTING OPPORTUNITIES

Pursuing small business set-asides, teaming with small business concerns or participating in the Small Business Administration (SBA) or Department of Defense mentor-protégé programs are several ways contractors can access federal construction contracting or increase their presence in the federal marketplace. The federal

government-wide goal for participation by small businesses is no less than 23 percent of the total value of all prime contract awards for each fiscal year.

A variety of programs exist to advance the interests of small businesses, such as those located in historically underutilized business zones (HUBZones), as well as those owned by service-disabled veterans (SDVOs), women, or other socially and economically disadvantaged individuals, including small disadvantaged businesses (SDBs) and Section 8(a) program participants.

Registering for these programs begins with the SBA determining a contractor's size. Beware, when the SBA considers size, it includes the size of the company's affiliates. Affiliation presents potential risks for small and large businesses depending on how they choose to pair up to compete for projects. Interestingly, a large business can offer bonding assistance, and that is not considered a disqualifying affiliation.

A large business may not joint venture on an 8(a) set-aside absent a mentor-protégé agreement.

The SBA's mentor-protégé program is designed to encourage approved mentors to provide various forms of assistance to eligible 8(a) participants as protégés. The purpose of the mentor-protégé relationship is to enhance the capabilities of the protégé and improve its ability to successfully compete for federal contracts. Mentors can take up to a 40 percent equity interest in their protégés to help them raise capital. No determination of affiliation or control will be found between a protégé firm and its mentor based on the mentor-protégé agreement.

The mentor and protégé firms must enter into a written agreement that lays out the protégé's needs and describes the assistance the mentor is providing to address those needs. The agreement must state that the mentor will provide assistance to the protégé for at least one year, and the SBA

Using Standard Contract Documents On Government Projects

By Kenneth Cobleigh and Susan Van Bell

Design professionals and contractors were optimistic when Congress passed the American Recovery and Reinvestment Act to stimulate the economy. A portion of the stimulus funds is allocated to federal projects and federally funded or insured projects that could create up to 14,000 jobs in the design and construction industries, according to the American Institute of Architects (AIA). As the distribution of funds prompts new construction projects, standard contracts will play an integral role in helping professionals efficiently navigate the building process.

Much of the stimulus money is dedicated for both "federal projects" and "federally funded or insured" projects. On a federal project, a U.S. government agency directly enters into a contract with architects or contractors, and the U.S. government is the project owner. These types of projects are governed by federal statutes and complex regulations, such as the Federal Acquisition Regulations (FAR) or, for military projects, the Defense Federal Acquisition Regulation Supplement.

In light of these statutes and regulations, which tend to be multifaceted, voluminous and subject to frequent change, federal agencies have created their own owner-architect and owner-contractor agreements. However, even on these projects, some standard contract documents can be used as the basis for consulting and subcontracting agreements (e.g., the AIA's A401, Standard Form of Agreement Between Contractor and Subcontractor, and C401, Standard Form of Agreement Between Architect and Consultant).

In addition, forms such as the G702, Application and Certificate for Payment; G703, Continuation Sheet; E201, Digital Data Protocol Exhibit; and E202, Building Information Modeling Protocol Exhibit, also can be used to effectively administer key activities.

For federally funded or insured projects, the federal government provides direct funding or insurance for construction that is performed for state or local governments or private entities, but the federal government is not the owner. These projects do not require use of FAR-based agreements, so standard contract documents that address the unique terms and conditions of these projects can be used for owner-architect and owner-contractor agreements. Many architects and contractors use these standard documents in conjunction with supplemental conditions developed by federal agencies.

An example of a standard contract document for such projects is the newly released AIA Document B108-2009, Standard Form of Agreement Between Owner and Architect for a Federally Funded or Federally Insured Project. This document, which was developed with the assistance of several federal agencies, includes specific provisions related to cost estimating, compensation and other issues tailored to these types of projects. The document will be useful to owners and architects working on federally funded and federally insured construction projects, including those funded by the recent stimulus package. B108-2009 is coordinated for use with A201-2007, General Conditions of the Contract for Construction. Several federal agencies have developed supplemental conditions for A201. For contractors, these agencies also have developed supplemental conditions for A101, as well as other AIA standard form agreements, so that these documents can be used on federally funded or federally insured projects.

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must approve the agreement. The agreement must not be merely a vehicle to enable a non-Section 8(a) mentor to receive 8(a) contracts. The mentor must have an active and approved subcontracting plan, and the protégé must be a certified small business under one of the SBA plans.

LIMITATIONS ON SUBCONTRACTING AND JOINT VENTURES

There are important limitations on SBCs, 8(a) set-asides, HUBZones, SDVO subcontracting and joint venturing with large businesses. For example, an 8(a) set-aside small business concern acting as a prime contractor must perform at least 15 percent of the cost of the general construction work (excluding materials) with its own employees. Similarly, a specialty trade small business concern must perform at least 25 percent of the cost of work (excluding materials) with its own employees. Repetitive subcontracts with the same firm are viewed as evidence of a disqualifying affiliation even if percentage limits are followed.

A large business may not joint venture on an 8(a) set-aside absent a mentor-protégé agreement. An 8(a) firm may enter into one or more joint ventures with other small business concerns to perform an 8(a) set-aside contract as long as the SBA approves the joint venture agreement. Members of a joint venture are deemed "affiliates" for the purpose of each acquisition in which they participate, with limited exceptions.

A large business may not joint venture with a HUBZone concern on a HUBZone set-aside.

Finally, a small business that subcontracts with a large business can be found to be an affiliate of the large business under the "ostensible subcontractor" rule. The purpose of the ostensible subcontractor rule is to prevent large firms from forming relationships with small firms to evade SBA size requirements. An ostensible subcontractor is one that performs primary and vital requirements of a contract or of an order under a multiple award schedule contract; or, a subcontractor upon which the prime contractor is unusually reliant. A contractor and its ostensible subcontractor are treated as joint venturers, and therefore affiliates for the purpose of size determination.

UNDERSTANDING THE RISKS

Contractors must understand the recent developments outside the ARRA, such as the requirement for comprehensive federal compliance and ethics programs under Federal Acquisition Regulation (FAR) Subpart 3.10. Under changes to the FAR, the federal government requires companies to have a written code of business ethics and conduct, and to implement it through an employee training program and ethics hotline.

A Contractor Code of Business Ethics is mandatory for all contracts exceeding $5 million or with a 120-day or longer performance period. A contractor may be suspended or debarred for any knowing failure by a principal to timely disclose credible evidence of a violation of federal criminal law involving fraud, conflict of interest, bribery or gratuity violations, or a violation of the Civil False Claims Act.

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Executive Insights

COUNSEL AND ADVICE

FROM LEADERS IN CONSTRUCTION LAW

BY DONALD BERRY

In the current economy, contractors are considering all their options. *Construction Executive* asked leaders in construction law for their advice on an array of legal issues, including the decision to sell, buy or merge a construction business; how to minimize the potential for contract document disputes; and what contractors should know before responding to a federal RFP.

"Contractors faced with an uncertain future may be considering buying a rival, selling the business or merging with another firm. What are the key factors to consider when making this decision?"

MICHAEL X. MCBRIDE
Managing Partner
Connell Foley LLP

The decision to buy, sell or merge a construction company is a difficult one and depends entirely on the objectives for the future of the business. If your company has a strong balance sheet and wants to expand into a different and growing market, consider buying a competitor in that market to gain a foothold. In large part, the decision to sell is driven by business conditions, family succession plans or tolerance for risk. The decision to merge is usually driven by the desire to cash out, yet remain active in the business with a larger and better capitalized company providing greater opportunity for growth.

BUYING A CONSTRUCTION COMPANY

My advice is to buy the assets of the company and not the stock. Pre-existing liabilities on environmental, tax and labor issues would remain with the former company. Significant due diligence of ongoing projects, including a close analysis of the costs to complete current jobs, should be carefully undertaken. In anticipation of a sale, sellers will sometimes book work at or below cost in order to create a backlog and increase the book value of the company.

Buyers also should review the in-house estimates on larger projects. Many purchasers encounter significant financial difficulties in completing ongoing projects from recently acquired companies.

I would also recommend extending the duration of the representations and warranties regarding taxes, insurance reconciliations and environmental issues. These issues inevitably surface three or four years down the road, by which time the seller no longer has the capacity, the funds or the commitment to deal with these issues appropriately.

Finally, all accounts receivables over 60 days should be written down to zero as part of the valuation process.

SELLING THE COMPANY

From a seller's prospective, I would recommend a stock sale so the liabilities belong to the buyer. We counsel clients to limit the duration of representations and warranties on environmental, tax and insurance reconciliations and litigation. In public transactions, we recommend our clients take cash rather than stock unless the company is a large, well-capitalized public company.

JWP, formerly the Jamaica Water Power Company, purchased numerous construction companies in the 1980s and 1990s with stock and eventually filed for Chapter 11. Numerous owners not only lost their respective companies; they never received full consideration from the sale.

With respect to accounts receivable, the seller should make every effort to reconcile them before closing, otherwise they will be written down to zero by the buyer's accountants.

Selling a company is always a difficult decision. It is usually driven by family members who have a low aversion for risk, are not interested in the business, or no longer want to sign indemnity agreements on the bonds or personal guarantees on the lines of credit. In most situations, it is better for the family members operating the business to buy out existing members and to stay in the business on their own. In addition, senior owners of the firm can sell the company to the senior employees in lieu of selling to a third party. In that way, the senior members can keep their hand in the business with the relationships they have established through their years in the industry.

MERGER

Companies usually merge in order to cash out their stock and to stay in business. Sometimes, a merger provides a better opportunity to expand the business into other markets and to help grow the company utilizing the expertise, assets and/or marketing exposure of a larger company. It is critical to maintain control of your own operation and the key people who understand the intricacies of your business and its business relationships. Employment agreements should be provided for your key personnel to help them compete and succeed within a large organization.

Many times, the managers and officers of the larger company simply do not

understand the business operations of the merged company, but they attempt to run the new business anyway. Your employees may become dissatisfied and leave. The opportunity to expand and succeed is lost.

There needs to be a clear understanding, before the merger, of who is going to run your business and the time period during which your key employees will continue to be able to make critical business decisions. This may be particularly important if you have received stock in the new company rather than cash.

Further, you should understand the business and strategic goals of the company with which you are merging. What are their officers and managers like? Are they handshake people, and do they understand your business? Will they work with you to grow your business or grow the business on their terms? Remember, it will be difficult to "unscramble" the egg if the competitive advantages do not materialize or are lost due to inexperienced or improper decision-making by others in the company.

"What advice do you have for contractors to minimize the potential for contract document disputes?"

MARK S. DACHILLE
Partner
Huddles Jones Sorteberg & Dachille, P.C.

Given the complexities and vagaries of the construction process, it is inevitable that problems will arise.

When they do, it usually doesn't take long before the question is asked, "Who is responsible for solving the problem?" That question often will send the parties scrambling through the contract documents.

If the contract documents do not clearly answer that question, there is a greater likelihood that the problem will become a dispute.

If the contract documents contain the answer, but that answer is contrary to what one of the parties expected, there is a greater likelihood that the problem will become a dispute.

If, however, the answer is clear and is consistent with what all of the parties intended, it is likely that the problem can be resolved without a dispute.

Contract disputes can and should be minimized by ensuring upfront that the contract documents clearly define all aspects of the parties' rights and responsibilities, and that they allocate risks and responsibilities consistent with the understanding of the parties.

"What advice would you give a contractor before signing a federal contract?"

REGGIE JONES
Partner
Smith, Currie & Hancock LLP

When it is time to sign the contract, it may already be too late for cost-effective legal advice. The most cost-effective advice begins prior to submitting an offer.

At that point, contractors must learn, and master, two tasks. Contractors must first learn how to write an acceptable proposal responsive to the Request for Proposals (RFP) and move away from the hard bid mentality. Second, contractors need to identify and quantify the additional management, administrative and reporting requirements contained in federal contracts. These requirements translate into additional overhead costs, which contractors must include in their offers. If contractors master these two tasks, they are more likely to get contract awards and be happy that they did.

With respect to the first task—proposal writing—contractors need to learn to write proposals that are responsive to each and every requirement contained in the RFP. Most federal construction contracts are no longer competitively bid, but rather are solicited using "best value" procurements based on the evaluation of a number of competitive factors, including past experience, key personnel, past performance and price. While price must be a factor in every solicitation, it is often the lowest priority. To succeed, contractors must scrub the RFP and create a simple checklist of all requirements. The contractor must then assemble simple, easy-to-read responses that effectively say, "yes, we comply," with each and every requirement called out in the RFP.

Elaborate dog-and-pony presentations are not necessary. Remember there are more offerors than ever before. The government evaluation teams are first culling out the non-responsive offers. So if the past experience factor requires each offeror to have completed three previous similar jobs over $15 million within the past five years, clearly list three jobs that meet that requirement within the appropriate time frame. Only after the minimum requirements are met should the contractor consider listing other projects.

With respect to the second task, federal construction contracts contain additional requirements (not found in most commercial contracts) that will affect the contractor's price. For example, Federal Acquisition Regulation (FAR) clause 52.246-12 (Inspection of Construction) requires the contractor to "maintain an adequate inspection system and perform such inspections as will ensure that the work performed under the contract conforms to the contract requirements." That is simple enough, but it is usually supplemented by a Contractor Quality Control (CQC) requirement in Division 01 of the specifications requiring at least one dedicated CQC officer (with no other responsibilities) to be onsite every day and to generate and submit detailed daily CQC reports.

Lastly, allowable costs are governed by Part 31 (Contract Cost Principles and Procedures) of the FAR. Contractors must set up their cost accounting to capture only costs that are allowable, allocable and reasonable under the FAR. Allowable costs under Part 31 are not the same as under the Internal Revenue Code. For example, advertising and entertainment expenses, which often are included in a contractor's general and administrative costs, are unallowable under FAR 31.205-1 and FAR 31.205-14, respectively. Similarly, the cost of alcoholic beverages is unallowable and cannot be included in a contractor's home office overhead under FAR 31.205-51.

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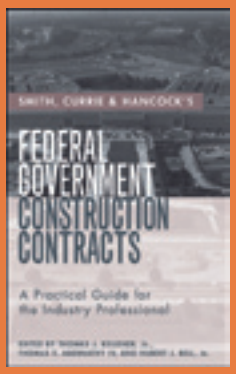
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