

The Practical Challenges of Contracting With Small Business Entities

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I. The Challenges of SBE Contracting

A. The U.S. SBA's Mission Statement

The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist and protect the interests of small business concerns, to preserve free competitive enterprise and to maintain and strengthen the overall economy of our nation. We recognize that small business is critical to our economic recovery and strength, to building America's future, and to helping the United States compete in today's global marketplace. Although SBA has grown and evolved in the years since it was established in 1953, the bottom line mission remains the same. The SBA helps Americans start, build and grow businesses. Through an extensive network of field offices and partnerships with public and private organizations, SBA delivers its services to people throughout the United States, Puerto Rico, the U. S. Virgin Islands and Guam.

B. SBA "Small" Business Size Limitations

- Commercial General Contractors = \$33.5 million
- Specialty Trade Contractors = \$14 million
- A DBEs owner's net worth must be less than \$1.32 million

C. Common Problems Associated With "Small" Businesses

- Under Capitalized
- Limited Resources
- Lack of Construction Experience & Sophistication
- Unfamiliar with Federal Contracting Requirements

SBA studies have shown that more than 50% of small businesses fail within four years.

D. Allocating Contract Dollars to SBEs

Hypothetical Scenario: The U.S. General Services Administration is going to build a new headquarters for a government agency. The project is a nine story office building containing approximately 2.1 million square feet. The cost of the project is \$326,000,000. The project delivery system is the traditional design-bid-build model with a single general contractor. The SBE “goal” is 30%. In other words, \$97.8 million of the contract dollars should go to SBE entities.

The Challenge: How do you award \$97.8 million worth of work to small, under capitalized companies that have a high probability of failing?

Option No. 1

The general contractor finds one really good SBE and awards that company a subcontract for \$97.8 million.

- Pro: The GC only has to manage one SBE subcontractor.
- Con: No SBE can handle a contract of this size.

Option No. 2

The general contractor finds 196 SBEs and issues each of them \$500,000 subcontracts.

- Pro: Smaller contract sizes increase the potential pool of SBEs.
- Con: The GC has to find 196 qualified SBEs.
- Con: The GC has to manage and coordinate the work of 196 SBEs.

II. Developing SBE “Friendly” Bid Packages

A. Bid Packages By Specification Section

Traditionally, general contractors will subcontractor work out by specification sections.

- Pro: Provides for a relatively defined scope of work.
- Pro: Provides continuity within the scope of work.
- Con: Often results in bid packages too large for SBEs.

B. Bid Packages By Dollar Amounts

In an effort to make the work more accessible to SBEs, bid packages will sometimes be developed based upon dollar amounts rather than specification sections. For example, the interior drywall partitions will be bid out by floor rather than the entire building.

- Pro: Lowers dollar amount of bid packages.
- Con: Certain scopes of work are difficult to subdivide.
- Con: Requires additional “upstream” management.
- Con: Results in duplicate general condition costs for trade contractors.
- Con: Results in loss of “learning curve” on project.
- Con: Results in additional mobilizations for out of sequence work.
- Con: Requires multiple contractors for punchlist and warranty work.

III. Contracting with SBE Entities

A. Typical Contract Arrangements

1. Traditional Lump Sum – based on a defined scope of work
2. Lump Sum – labor only
3. Unit Price – typically labor only
4. T & M with GMP – typically labor only

B. Key Contract Issues

1. Payment Terms – less than monthly; other than percent complete
2. Supplier & Subcontractor Payment Terms – lien waivers; joint checks
3. Performance Terms – ability to supplement and/or default
4. Employee Requirements – E-verify; Drug Testing; Proof of Pay Checks
5. Workers' Compensation – state specific
6. Certified Payroll Reports – weekly submission
7. Subcontractor Sign-in – daily requirement
8. Insurance Provisions – additional insured status

C. Alternative Contract Arrangements

1. Joint Ventures
2. Teaming Agreements
3. Mentor – Protégé Program

IV. Potential Legal Pitfalls

A. Default – The SBE Fails to Properly Perform its Work

- Fails to Pays its Employees Prevailing Wage
- Fails to Pay its Suppliers
- Fails to Perform its Work on Schedule
- Fails to Meet Quality Standards
- Not Around to Perform Warranty Work

B. Joint Liability – “Supporting vs. Controlling” the SBE

- Wage & Hour Violations
- OSHA Violations
- EEOC Violations
- Visa Violations
- Misclassification of Employees as Independent Contractors

C. Sham SBE Contractors

- Misrepresents its “Size”
- Misrepresents its “Controlling Owners”
- Fails to Disclose its “Affiliations”