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BEFORE THE

COMMITTEE ON SMALL BUSINESS

SMALL BUSINESS SUBCOMMITTEE ON CONTRACTING AND WORKFORCE

UNITED STATES HOUSE OF REPRESENTATIVES

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Chairman Hanna, Ranking Member Takai, and members of the Subcommittee, my name is James Fontana, and I am a founding member of the Dempsey Fontana law firm which is located in Reston, Virginia. For over 30 years my law practice has focused almost exclusively on government contracts. During that time I have served as an attorney in both major law firms to include Reed Smith and Kominers Fort, and as a general counsel for some of the most recognizable government contractors such as BDM, Wang Federal and Apptis Holdings. Our law firm's practice is focused particularly on the business and legal issues faced by small government contractors and in that respect we represent a good number of Information Technology Value Added Resellers or ITVARs. I thank you for the opportunity to testify today to discuss the continuing challenges of those small companies doing business with the federal Government.[1]

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[1] In preparing this Statement, I gratefully acknowledge the valuable assistance of my partner, David B. Dempsey.

Today I am testifying on behalf of 13 small IT-VARs that have formed an ad hoc coalition called the Value-Added Reseller Coalition, better known as "VARC". These companies, which are representative of thousands of other similarly situated IT-VARs around the nation, compete on individual agency small business set-aside solicitations or multi-billion dollar agency program requirements "reserved" only for small businesses. The VARC members fall under various SBA programs including Small Disadvantaged Businesses, Women-Owned small businesses Service-Disabled Veteran-Owned Small Businesses ("SDVOSB"), and small businesses that are located in what are known as HUBZones.

On behalf of the VARC and I am sure many other small IT-VARs, I am sharing my concerns with regard to the actions of the Small Business Administration ("SBA") in promulgating proposed regulations in a way that is inconsistent with applicable legal standards, and in particular the SBA's September 2014 proposed rulemaking that I believe was ill-conceived from a legal, logical and common sense standpoint, and which proposed regulations, if finalized, will have a devastating impact on many small government contracting businesses to include the VARC members, as explained in more detail below. In making this statement I emphasize that I have the greatest respect for Executive Branch agencies and I have had the privilege of working with many federal agencies, to include the SBA, during my many years as a government contracts lawyer.

Also today I am expressing my support for H.R. 1429, the Stronger Voice for Small Business Act of 2015 (the "Act"). The underpinnings of my support are twofold: First, businesses selling goods and services to the Government that are certified as "small" under regulations promulgated by the SBA face increasing regulation of their business and in particular are subject to the SBA's changing size standards. As you are aware, the Small Business Jobs Act of 2010 (the "Jobs Act") directs the SBA conduct a detailed review of all size standards every five years and to make appropriate adjustments to reflect market conditions.[2] The only avenue for these small companies to challenge a size standard established, revised or modified by the SBA is for such companies to file a federal lawsuit against the Government pursuant to the Administrative Procedure Act (the "APA").[3]

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[2] *See* Pub. L. No. 111–240 § 1344, 124 Stat. 2504, 2545 (Sept. 27, 2010). More specifically, the Jobs Act requires SBA to conduct a detailed review of at least one-third of all size standards during every 18-month period from the date of its enactment. The Jobs Act requires further that the SBA review all size standards not less frequently than once every five years thereafter. Reviewing existing small business size standards and making appropriate adjustments based on the latest available data are also consistent with Executive Order 13563 on improving regulation and regulatory review. As noted below, additional requirements for SBA size standards were enacted under the National Defense Authorization Act of 2013 ("2013 NDAA").

[3] 5 U.S.C. §§ 500 *et seq*. Judicial review of an agency's proposed rulemaking is available under the APA if a plaintiff is "adversely affected or aggrieved" by any final agency action "within the meaning" of the statute at issue. 5 U.S.C. § 702. We note that the Proposed Rule as published in September 2014 reflected the revenue-based size standard of *$25.5* million and the SBA's October 20 publication properly corrected that this standard is currently *$27.5* million. It appears, however, that the SBA based its so-called market analysis on the $25.5 million revenue

This Act will allow small firms a quicker and much less expensive administrative forum to challenge such size standards. Petitions before the SBA's Office of Hearings and Appeals ("OHA"), much like the similar process used to file protests of a contractor's size or other status and the OHA appeal process for the SBA's decisions on such protests, are relatively short and simple, as opposed to the mounds of pleadings, motions, discovery and hearing-related documents that are required to be filed to initiate and maintain an action before a federal district court. Small businesses typically lack the resources to file such expensive lawsuits to challenge SBA rulemaking actions which may later prove to be arbitrary, capricious and otherwise not in accordance with applicable laws. Under this Act, small companies will be afforded a way to pursue such legitimate challenges before the OHA without going through the expense of a full-blown and protracted lawsuit.

Second, the administrative forum created by the Act is particularly needed at this time given the SBA's recent proposed deletion of the 150 employee-based size standard contained under North American Industry Classification System ("NAICS") Code 541519, Note 18. On September 10, 2014, the SBA published a proposed rule that would remove the Information Technology Value Added Resellers ("ITVAR") Sub-Industry exception under NAICS Code 541519. This exception contains the 150 employee-based size standard under Note 18 of that NAICS Code and, if eliminated, would leave only the $27.5 million revenue-based size standard.[4] The SBA had recently stated to me in a meeting on March 24, 2015 that it expects to finalize the Proposed Rule sometime this summer.[5]

There are a number of reasons why the Proposed Rule should not be implemented and represents a valid backdrop for the Act. Indeed, the Act would afford small businesses, to include ITVARs, the opportunity to correct the inexplicable policy error resulting from the Proposed Rule from a legal, economic, judgmental and common sense standpoint. As explained in more detail below, the Proposed Rule is **not** supported by relevant data and is completely contrary to the SBA's prior exhaustive analysis performed in 2002-2003 (and reaffirmed in March 2011), which established the 150 employee-based size standard as **the** proper one under Note 18. The

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standard. Although in this Statement along with our comments to the SBA we used the higher standard, the analysis and conclusions provided here do not change appreciably.

[4] *See* Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, 79 Fed. Reg. 53646 (Sept. 10, 2014), as amended in 79 Fed. Reg. 62576 (Oct. 20, 2014) (the "Proposed Rule").

[5] This firm, along with about 170 other companies, individuals and organizations, filed comments in response to the Proposed Rule. An overwhelming majority of those comments, as with our comments, were opposed to the SBA's proposed elimination of the Note 18 exception. We also appreciate the letter sent to the SBA by then Chairman Graves, dated November 10, 2014, in opposition to the Proposed Rule. Although there is opposition to other parts of the Proposed Rule's changes to various NAICS codes, our focus here is on NAICS 541519, Note 18. Our office continues to correspond with the SBA to provide input with regard to the Proposed Rule with respect to the Note 18 exception.

Proposed Rule would also have a devastating impact on many small businesses now providing information technology ("IT") products and services to the Government as they will be ineligible to receive set-asides, and it will significantly curtail the Government's ability to count on a reliable small business industrial base to provide these products and services. More importantly, the Proposed Rule violates the explicit legal standards enacted by the Congress.

A. Background

The Proposed Rule is a perfect example of why the Act should be enacted by Congress. ITVARs sell IT products (hardware and software), solutions and related services to the U.S. Government under NAICS 541519, Note 18. These companies compete on individual agency small business set-aside solicitations or multi-billion dollar agency program requirements "reserved" only for small businesses.[6] Such companies fall under various SBA programs including small disadvantaged businesses, women-owned small businesses ("WOSB"), service-disabled veteran-owned small businesses ("SDVOSB"), and small businesses that are located in historically underutilized business zones ("HUBZones"). These types of small business ITVARs are awardees who benefitted through the "reserve" portion of such multi-billion dollar agency acquisition programs as the Department of Homeland Security's ("DHS") First Source II, and NASA's SEWP V as well as other Government-Wide Acquisition Contracts ("GWAC"), individual contracts and task and delivery orders that rely on Note 18's exception to the revenue-based size standard (currently $27.5 million) for NAICS Code 541519.

Small ITVARs seeking their fair proportion of Government small business set-aside awards rely heavily on NAICS Code 541519, Note 18, as do procuring agencies that are required by federal statute to award at least 23 percent of all prime Government contract dollars to small businesses. The SBA's proposed change to NAICS 541519 to a receipts-based only size standard would greatly impact the small companies that depend upon those contracts to grow organically. By eliminating the 150-employee size standard exception to the NAICS Code 541519 receipts-based size standard contained in Note 18,[7] the Proposed Rule would ***exclude*** any otherwise "Note 18" small ITVAR business with annual receipts in excess of $27.5 million from pursuing small business set-aside opportunities currently available to them. Many, if not most, small ITVARs easily exceed the $27.5 million receipts threshold because the ITVAR business model (of which the federal agencies readily avail themselves to meet their annual small business contracting

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[6] "Reserve" set-asides are particularly well-suited for the small business IT industry and federal agency procurement offices because these reserved set-asides allow contracting officers to obtain the well-acknowledged IT expertise of small companies. The SBA appears to have completely ignored the "reserve" procurement method made available through the IDIQ, multiple award contract vehicle. The irony is that such reserves came about from §1331 of the Jobs Act (see 77 Fed. Reg. 29130, 29139-41 (May 16, 2012)(proposed rule); 78 Fed. Reg. 61114, 61134-35 (Oct. 2, 2013), and the SBA's Proposed Rule would have the effect of eliminating jobs for many ITVARs.

[7] "Receipts" is defined as "total income" (or in the case of a sole proprietorship, "gross income") plus "cost of goods sold" as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms." 13 C.F.R. § 121.104(a).

goals) requires a high volume of product sales (*i.e.*, "cost of goods sold") due to the low profit margins in this highly competitive industry. Thus, although annual receipts of an ITVAR appear high, these receipts do not reflect an ITVAR's profits because such the dollar value of an ITVAR's receipts are based almost exclusively on the volume of IT-related products which is a pass-through cost and not reflective of the associated value-added services provided to the Government. This makes the $27.5 million receipts-based size standard a less accurate, and indeed on balance an improper, measure of the true size of the small ITVAR. Note 18's employee based standard is, therefore, critical to ITVARs because these companies have a very small number of employees in relation to their revenue stream, especially when compared to companies which provide mostly IT services.

B. The SBA's Analysis is Based Upon Non-Existent, Incomplete or Inapplicable Data

The SBA's basis for the elimination of the ITVAR 150-employee size standard is unsupported by the data cited in the Proposed Rule. For example, the SBA states:

> SBA's analysis of 2007 Economic Census data shows that 150 employees is more or less equivalent to [$27.5] million receipts in NAICS 541519 and that more than 99 percent of firms below the 150-employee level will continue to qualify as small under the [$27.5] million receipts based size standard. Thus, the proposed elimination of the ITVAR sub-industry category and its 150-employee size standard, if adopted, will have very minimal impact on businesses below 150 employees.

Proposed Rule at 53656.[8]

Not only does the SBA completely ignore the pass-through costs/receipts of IT hardware, but it is almost incomprehensible how the SBA could have reached its "minimal impact" conclusion regarding the continued qualification of 99 percent of ITVAR firms on "2007 Economic Census data." The SBA acknowledged elsewhere in the Proposed Rule that "the data from the Census Bureau's tabulation are limited to the 6-digit NAICS industry code and hence *do not provide economic characteristics at the sub-industry level … (that is, one of the exceptions)*." Proposed Rule at 53651 (emphasis added). In other words, the SBA clearly admits that the Economic Census Data (for any year) does not in fact provide the economic basis which the SBA employs to justify the elimination of the specific "sub-industry" that was established in 2002. Given that the 150 employee standard is an exception to NAICS code 541519 receipts-based size standard, the SBA's statement that it relied on 2007 Economic Census data is ludicrous because the

[8] We note that SBA based its analysis on the 2007 Economic Census tabulation, which the SBA claims is the "latest available." *See* Proposed Rule at 53649. The SBA, however, appears to have ignored that their data is (1) seven years old and (2) does not contain any information about the companies that actually received contract awards based on the 150 employee-based exception under Note 18. *Id.* Thus, by SBA's own admission, it has no knowledge of what or how many small ITVARs received awards based on Note 18 (150 employees) versus the receipts-based qualification for NAICS Code 541519.

economic data that the SBA used is related solely to IT services companies and not for ITVARs the provide services and hardware and software. In effect, SBA is arbitrarily using apples to eliminate oranges. We believe that the SBA needs to review the data that we reviewed – that is, actual procurement data that could be made available to the SBA from the procuring agencies if not from available public sources. Absent such a proper analysis of this data along with other available market data that the SBA is required to consider under the Jobs Act and the more recent 2013 NDAA, ITVARs, like other small businesses, should have an alternative forum to challenge the Proposed Rule along the lines afforded by the Act.

It appears that the SBA concedes there is no "economic" data to support its conclusion that more than 99 percent of the firms below the 150 employee level will continue to qualify as small businesses under the NAICS code 541519 receipts-based qualification. In other words, SBA acknowledges that the data used to justify its Proposed Rule is inapplicable. The problem with the SBA's reliance is underscored by the data in **Attachment A** which clearly demonstrate that 150 employees is not even remotely equivalent to $27.5M in annual receipts for a small business ITVAR. Many small ITVARs have annual receipts exceeding $27.5M, while employing substantially fewer than 150 employees. Indeed, the only VARC member with somewhat comparable annual receipts (approximately $30M) has only 25 employees, or less than a sixth of what the SBA assumed to be the case.

C. The Data Provided in Attachment A Directly Contradicts the SBA's Conclusions

Significantly, virtually all of the ITVAR companies that this law firm represents to include the VARC members would become instantly ineligible for small business set-asides or reserves under the Proposed Rule because the annual receipts of these 12 companies exceed $27.5 million but have fewer than 150 employees.[9] Also, and as discussed further below, our own data contained in **Attachment A** to this Statement establishes that numerous other currently small ITVARs will also instantly become large businesses if the Note 18 exception is eliminated as proposed.[10]

Contrary to the SBA's admittedly inapplicable "economic data," the majority of the small ITVARs that we reviewed will lose their small business size status under this NAICS Code if the 150 employee based size standard is eliminated because their annual receipts (averaged over a three year period) exceed $27.5 million. Using relatively straightforward survey of ITVARs that

[9] Twelve of our VARC members have annual receipts exceeding $27.5 million but have fewer than 150 employees. Indeed, all of the VARC members have average annual receipts of nearly $123 million but only an average of 50 employees.

[10] Please note that the data provided in **Attachment A** was also provided to the SBA in our comments in opposition to the Proposed Rule, although updated for the Subcommittee to reflect recent additional contract awards. We intend to provide the revised data to the SBA as well. *See* note 11, *infra*.

received awards under some of the largest "Note 18" reserved GWAC shows that SBA's attempted correlation of receipts to employees is simply wrong when applied to the IT community. In particular, many "Note 18" small ITVARs (and certainly ***not*** merely 1 out of 100) will lose their size status under NAICS Code 541519 upon the elimination of Note 18's 150 employee-based standard.

Our conclusion with regard to the faulty SBA data is supported by data that we have obtained from publically available federal agency websites, the Federal Procurement Data System ("FPDS") website and the USASpending.gov website. **Attachment A** to this Statement lists those small businesses awarded contracts under DHS First Source II ("FSII"), U.S. Air Force Netcentric 2 Products (" NETCENTS-2"), NASA Solutions for Enterprise-Wide Procurement V ("SEWP V") and U.S. Department of Health and Human Services, National Institutes of Health ("NIH") Chief Information Officer – Commodities and Solutions ("CIO-CS") procurements – all "reserved" acquisition programs per the Jobs Act.

As reflected in **Attachment A**, the publicly available data shows that 17 small ITVAR awardees under the DHS FSII contract have under 150 employees and annual receipts above $27.5 million, accounting for 63 percent of the total number of small business FSII small business awardees. With respect to the Air Force NETCENTS-2 small business reserved contract awards, 7 small ITVARS have under 150 employees and have annual receipts above $27.5 million, accounting for 64 percent of the total number of small business NETCENTS-2 awardees. Under the NASA SEWP V contract, 43 small ITVARS have under 150 employees and have annual receipts above $27.5 million, accounting for 41 percent of the total number of small business SEWP awardees. Under the NIH CIO-CS contract, 27 small ITVARS have under 150 employees and have annual receipts above $27.5 million, accounting for 67.5 percent of the total number of small business CIO-CS awardees. All of these businesses, or a total average of ***43 percent*** of the total number of awardees that are currently qualified as small under NAICS Code 541519, Note 18, will not qualify as small under the Proposed Rule.[11] We emphasize that our data is based on the awardees and does not include the hundreds of other small ITVARs that submitted offers for each agency's small business reserved acquisition. [12]

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[11] The original data in **Attachment A** that was supplied to the SBA in November reflected that 51% of the small ITVARs would lose their size status under the Proposed Rule. However, some of this data has since changed. For example, SEWP V added a significant number of new small ITVAR awardees after various bid protests were filed and NASA took corrective action leading to these additional awards. In addition, the CIO-CS contract was awarded which added an additional contract vehicle to this list. Although the total percentage of adversely impacted ITVARs has since fallen to 43 percent (primarily due to the changes in the SEWP awardees), this percentage is still significantly higher than the 1 percent of the ITVARs that the SBA concluded would be adversely affected by the Proposed Rule.

[12] Federal agencies use these large IDIQ contract vehicles to procure billions of dollars of hardware, software and related services from both large and small ITVARs. The publicly available information from these *actual* contract awards show many such awards are made to small ITVARs with less than 150 employees and more than $27.5 million in annual receipts. Agencies will almost certainly reduce, if not cease, making awards under these contracts

Thus, even a cursory look at publically available data illustrates the certainty that many more than 1 percent of the firms will lose their small business status under NAICS Code 541519 if Note 18 is eliminated as proposed. In addition, our data shows that virtually all of these companies with receipts above $27.5 have substantially fewer than 150 employees.[13] Put another way, with regard to the companies listed in **Attachment A**, where actual data exists, the average dollar amount of annual receipts is approximately $41,790,715 and the average number of employees is 38. This data is completely contradictory to the SBA's conclusion that an ITVAR with "150 employees is more or less equivalent" to a firm with $27.5 (or even $25.5) million in revenue. Proposed Rule at 53656. The available data reflects that such receipts are, on average, much higher for this employee headcount.

We respectfully conclude that the SBA has no actual or even anecdotal data to support its statement that 99 percent or even a majority of small ITVARs will continue to be small using only the receipts-based standard under NAICS 541519. The SBA's lack of data and the existence of data contradicting the SBA's basis for the Proposed Rule is the very reason not to change the exception to NAICS Code 541519 provided by Note 18. We note that SBA should obtain a list of offerors for each agency's procurements conducted under NAICS code 541519, Note 18 and then use the data from the FPDS and USASpending websites to identify the actual annual receipts and the number of employees – as we did in **Attachment A**. Following that exercise, the SBA can much more accurately estimate the number of small ITVARs that will no longer qualify as small businesses if the Proposed Rule is adopted. We also encourage the SBA to learn what ITVARs actually do for federal agencies because if the SBA had known and understood the difference between an IT services company versus an ITVAR, we believe that the SBA would not have proposed the elimination of Note 18.

In short, the SBA failed to provide relevant (**much less actual**) market data or adequate justification for removing Note 18 from NAICS 541519. On the contrary, SBA's proposed change to NAICS 541519 would only succeed in harming small ITVARs and will greatly impede the ability of federal agencies to fulfill their programs that now set aside billions of dollars for small business concerns meeting the current 150-employee size standard.

D. The SBA Has Failed to Justify its Departure from the Already Established Employee Standard

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to small ITVARs in the future in the Proposed Rule is adopted because agencies will no longer receive small business goal credit for such small business set aside awards.

[13] We acknowledge that the FPDS data may not necessarily reflect a three-year average of annual receipts; however, a good number of our clients are listed as awardees under the SEWP V and First Source II contracts and their three year average receipts are definitely consistent with the FPDS-generated data shown in **Attachment A** and notes thereto. We acknowledge the somewhat incomplete nature of our data, but such numbers clearly indicate that the SBA's conclusions and the reason for its conclusion with regard to the average number of employees of an ITVAR with $27.5 million in revenue as well as the "minimal" impact of the Proposed Rule are completely incorrect.

The SBA was unequivocal in 2002 and 2003 in explaining that an employee-based size standard was the most rational and fair standard for ITVARs. In that notice of proposed rulemaking, SBA made it clear that: "In recognition that a substantial amount of the dollar value of the contract will be for hardware and software sales, ***an employee size standard is considered an appropriate size standard*** to measure the magnitude of operations of IT Value Added Resellers." *See* Small Business Size Standards; Information Technology Value Added Reseller, 67 Fed. Reg. 48419, 48420 (July 24, 2002) (emphasis added) (the "2002 Proposed Rule"). In the final rule that was published in 2003, the SBA similarly stated that

> Based on a review of ITVAR industry characteristics, the SBA is adopting a 150 employee size standard, which it believes more sufficiently considers the overall characteristics of the types of firms engage [sic] in ITVAR activities. . . ***An employee size standard is considered a better measure of the size of ITVARs operation than receipts since a substantial proportion of their receipts merely reflect the dollar value of equipment and software sold.***

68 Fed. Reg. 74833 at 74834 (emphasis added). The SBA based this conclusion on a detailed, quantitative analysis of data concerning ITVARs, including the average firm size, the distribution of firms by size, startup costs, industry competition, the impact of size standard revision on the SBA programs, and its analysis of public comments. 68 Fed. Reg. 74833 at 74837-39. No such analysis was provided in the Proposed Rule. Indeed, as recently as 2011, the SBA continued to believe that a 150-employee based standard was the most appropriate. *See* Small Business Size Standards: Professional, Scientific and Technical Services, 76 Fed. Reg. 14323, 14333 (Mar. 16, 2011) ("In this proposed rule, the SBA proposes to retain the current 150 employee size standard for ITVAR."). Thus, the SBA has long recognized that receipts are not an accurate measure of the size of a small ITVAR and that the number of employees is more accurate.

It is well-settled that "an agency changing course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first place." *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 42 (1983); *see also Atchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. of Trade*, 412 U.S. 800, 808 (1973) (an agency has a duty to "explain its departure from prior norms"). The Proposed Rule does not contain the requisite analysis to justify reversing course on the Note 18 150-employee based standard.

There is no reason -- nor does the SBA provide any reason -- to suggest why the explanation and rationale provided in 2002 and 2003 (and continued in 2011) no longer applies today. The Proposed Rule makes no comparison with the 2002, 2003 or 2011 rulemaking analyses and provides no facts or reasons regarding changes in the ITVAR industry and the federal IT procurement marketplace that justifies the SBA's complete about face on the employee size standard articulated in Note 18. In fact, nothing has changed and the SBA has not provided a single reason that addresses much less adequately explains why an employee size standard is no longer a "better measure" of the size of an ITVAR operation or why the elimination of this size standard is in any way warranted.

The SBA's sole justification in the Proposed Rule for rescinding the employee based size standard is that it has "created some inconsistencies, confusion and misuse." Every example cited by SBA, however, is vague, conjectural and speculative. In its first example, SBA asserts that "the public often believes" that a firm that received an award under NAICS 541519, Note 18 is not actually small based on its annual receipts because contracting officers cannot identify size standard exceptions in Federal Procurement Data System – Next Generation ("FPDS-NG"). Proposed Rule at 53656. This alleged "confusion" is entirely speculative and predictably the SBA provides no data, examples or other details that support the existence of "public confusion." Therefore, SBA's conclusory statement cannot possibly justify or otherwise rationalize the complete demolition of the Note 18 exception. To the extent such confusion does exist, it would suggest that FPDS-NG should be modified to include a data point for Note 18 as opposed to eliminating this particular exception.[14] Put another way, the SBA should not arbitrarily throw the baby out with the bath water in promulgating rules that have a significant impact on the small business community. Even still, as noted above, a compilation of other data available from FPDS provides more than a sufficient basis to conclude that elimination of Note 18 would result in many small business firms becoming ineligible under NAICS Code 541519 in the future.

Moreover, the SBA states that there are "many cases where Federal agencies have applied the 150-employee size standard, instead of the receipts based size standard" and that this "*may have* benefited more successful, mid-size companies at the expense of those below the receipts based size standard." *Id.* Emphasis supplied. The fact that SBA does not and cannot know for certain whether "more successful, mid-size companies" are benefiting is telling of the lack of analysis

[14] The SBA has correctly pointed out that it is both difficult to determine compliance with the Note 18 standards under NAICS 541510 and that there may have been certain abuses to that standard, or at least that some ITVARs and procuring agencies have not fully monitored such compliance, especially with regard to the requirement under Note 18 that the ITVAR provide at least 15 percent and no more than 50 percent of the value added services. We believe that the SBA has not fully appreciated the business and organizational models of the ITVAR both from a pre-sales, sales and engineering standpoint as well as the service delivery aspects of this business. An ITVAR will provide a vast number of pre-award and post-award services that are required to successfully execute a solution on any given Government contract or task order. We understand that at least one procuring agency has offered to develop for the SBA written guidance regarding the proper implementation of the Note 18 exception, and such guidance is also included directly within the CIO-CS contract. To the extent any inconsistencies, confusion or misuse actually exists with regard to the proper application of the Note 18 exception, we submit that this type of guidance would address the SBA's concerns and eliminate or greatly mitigate such inconsistencies, confusion or misuse.

supporting the Proposed Rule.[15] The SBA's conjecture here falls far short of the reasoned analysis necessary to justify its rescission of its prior rule.

One of the many benefits that ITVARs currently bring to the Government is their ability to offer a comprehensive catalogue of products along with their value enhancing services, including network infrastructure and security assessments, training, project management, network consolidation and virtualization deployments, hardware/software installation/integration, help desk support and maintenance. Eliminating the employee based size standard here will eliminate significant depth to the products and services the Government currently receives from small ITVARs pursuant to this NAICS Code.

E. The SBA's Alternative to Note 18 Is Illogical and Will Cause Undue Competitive Harm to the Small ITVAR

The Proposed Rule observes that, "instead of using the ITVAR 150-employee size standard under NAICS 541519, a contracting officer could use a manufacturing NAICS code and size standard, such as NAICS 334111 (Electronic Computer Manufacturing) with 1,000-employee size standard, to which the non-manufacturer size standard of 500 employees would also apply." Proposed Rule, at 53656. This is a problematic and illogical approach. To begin with, the fact that an alternative purchasing method exists does not justify eliminating a well-established NAICS size exception. In addition (and as the SBA stated in 2002 and 2003), NAICS Code 541519, Note 18 is unique for the ITVAR community and its virtual elimination would create an undue burden for the small ITVARs by forcing them to compete in various manufacturing NAICS that are not designed for the supply sector of the federal IT industry, which is dominated by much larger companies. Moreover, the various manufacturing NAICS Codes do not include the above-mentioned value added services that ITVARs offer in connection with its product sales. More importantly, the procuring agencies are seeking to benefit from the ITVAR's expertise, experience and knowledge -- not simply desktops and laptops -- but integrated systems and IT planning which is implemented to one degree or another by the agency's purchase of the appropriate IT products and services.

Finally, resorting to a manufacturing NAICS code forces small ITVARs to meet a restrictive standard under the SBA's non-manufacturing rule ("NMR") unless there is a class waiver issued by the SBA or an individual waiver of the NMR issued by the contracting officer (for the specific procurement action) and approved by the SBA.[16] This waiver process is highly cumbersome and in some cases such waivers are difficult to obtain in a timely fashion even if the

[15] We also fault the SBA's logic regarding its reference to "many cases." That is, the only reason such "mid-size companies" become "mid-size" in the SBA's logic is because the SBA applies the consequences of its Proposed Rule to past circumstances. It appears, however, that the SBA does not know and has made no effort to learn such facts.

[16] The SBA's regulations allow small businesses to avoid this requirement only if it receives either an individual waiver by a contracting officer or a class waiver from the SBA. Id. § 406 (b)(5), (6).

circumstances justify a class waiver or the contracting officer has valid justification for an individual waiver.[17] Additionally, the NMR would significantly limit the number of product offerings a small business could offer to the Government because realistically either individual NMR waivers issued by a contracting officer for SBA approval or class waivers issued by the SBA are not always available and at the very least tend to delay important procurements. While there are certainly many great IT products made by small businesses, agencies will not get the benefit they seek from ITVARs if the ITVAR can only offer a fraction of the products available on the market. Thus, at the very least, the NMR restricts the small ITVAR from providing the full spectrum of desired products to agencies and causes delays in the procurement process.

F. The SBA Failed to Follow the Jobs Act and 2013 NDAA Requirements in Issuing the Proposed Rule

We appreciate that, as part of its comprehensive size standards review required by the Jobs Act, the SBA must evaluate employee-based size standards for all 364 industries in the various applicable NAICS sectors to determine whether they should be retained or revised, and the SBA has professed in the Proposed Rule that it was responding to the Jobs Act's requirements. Having said that, and as stated above, Section 1344 of the Jobs Act is very clear on the requirement that the SBA "make appropriate adjustments to the size standards . . . to reflect market conditions." More recently, Section 1661 of the 2013 NDAA amended Section 3 of the Small Business Act to allow common size standards among related industries only if the SBA finds that the common size standard is appropriate for each industry independently. The amendment also prohibits the SBA from limiting the number of size standards, and requires that the SBA assign the appropriate size standard to each NAICS. Significantly, this provision further requires the SBA to consider, in its proposed rulemaking with regard to size standards,

> (A) a detailed description of the industry for which the new size standard is proposed;
> (B) an analysis of the competitive environment for that industry;
> (C) the approach the Administrator used to develop the proposed standard including the source of all data used to develop the proposed rulemaking; and
> (D) the anticipated effect of the proposed rulemaking on the industry, including the number of concerns not currently considered small that would be considered small under the proposed rulemaking and the number of concerns currently considered small that would be deemed other than small under the proposed rulemaking.

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[17] The difficulty of obtaining such waivers is underscored by the small number of class waivers that the SBA provides for IT equipment. For example, under NAICS 334111, there are only three class waivers for IT-related products. This indicates the absence of a sufficient number of small business manufacturers to fulfill the Government's IT requirements. See www.sba.gov/sites/default/files/NMR%20CLASS%20WAIVER%20LIST-AS%20OF%2012-31-2013-VERSION%2010.pdf.

15 U.S.C. §632(a)(6).[18]

As noted above, none of the SBA's data properly reflects the current federal marketplace, and in particular the business of the ITVAR.[19] On the contrary, it appears quite clear that the SBA does not have and did not use applicable, complete, relevant or current market data regarding the impact of removing the Note 18 employee size standard from NAICS Code 541519. More pointedly, with such an obvious flaw in the data, the SBA's passage of the Proposed Rule violated the congressional dictates of Section 1661 and would, therefore, under any objective standard, be considered arbitrary, capricious and an abuse of the SBA's discretion with respect to its rulemaking authority. Again, by contrast, our data shows that at least 43 percent of ITVARs currently qualified under Note 18 who have received recent awards under First Source II, NetCents-2, SEWP V and/or CIO-CS contracts **will lose** their small business size status if the Proposed Rule is adopted.

CONCLUSION

The SBA's proposed change to NAICS 541519 will have a severe negative impact on the small companies that depend upon those contracts. The substantial adverse impact of SBA's proposed change may force many small ITVARs to lay off employees or shut down their businesses entirely. In forcing these small ITVARs out of the market, competitive bids to the Government will be reduced.

The Proposed Rule will also have a particularly significant impact on those small businesses owned by disabled American veterans, women and those HUBZone-certified companies who have located their businesses in economically distressed areas around the country. By affecting thousands of employees working for the small ITVAR community, the Proposed Rule will have a detrimental effect on the local economies in which these businesses are located. This significant negative impact on small businesses and their employees is not justified by the rationale set forth in the Proposed Rule, which it is not supported by objective data, and contradicts SBA's own conclusions on the same issue without adequate explanation for the significant departure from prior policy.

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[18] We believe (and agree with Rep. Graves in his November 10 letter) that the SBA has violated other standards under Section 1661 not only with regard to NAICS 541519, Note 18 but also with regard to other revised size standards as set forth in the Proposed Rule, to include violation of the common size standard requirements under 15 U.S.C. §632(a)(7), as well as the SBA's improper limitation of size standards addressed in the Proposed Rule in violation of 15 U.S.C. §632(a)(8). Graves letter at pp. 9-11.

[19] The Proposed Rule stated that "SBA welcomes comments on its methodology for incorporating the Federal contracting factor in its size standard analysis and suggestions for alternative methods and other relevant information on small business experience in the Federal contract market that SBA should consider." Proposed Rule at 53653. During our March 24 meeting, SBA officials stated that they were considering our alternative data as provided in **Attachment A** and invited us to provide additional data for the SBA to consider.

Equally significant is that the Proposed Rule will force the small ITVAR that survives this change to compete with large ITVARs having significantly higher annual receipts, substantially more employees and significantly higher levels of resources, which is directly contrary to the SBA's mission to assist small companies in competing with large companies on an even basis. Eliminating the 150 employee-based standard will cause companies to be either very small or very large. This is what the SBA is here to prevent – not facilitate - by eliminating the path to success for many small ITVARs.

For these reasons, I believe that the SBA should withdraw the Proposed Rule and consult further with the procuring agencies and affected small ITVARs, as well as this Subcommittee. In addition, Congress should adopt the Act to allow small businesses, including small ITVARs, the ability to administratively challenge these proposed changes to the NAICS to fully and fairly protect their interests.

Again, thank you for the opportunity to testify at this hearing. I will be pleased to answer any questions you or any member of the Subcommittee may have.

Attachment A

List of Small Business Awardees Under
DHS First Source II, Air Force NETCENTS 2, NASA SEWP V and NIH CIO-CS Contracts
As of May 29, 2015

DHS First Source II Awardees	NUMBER OF EMPLOYEES	ANNUAL REVENUE	Notes
Akira Technologies	1	$250,000.00	
Affigent	97	$151,655,216.00	
Alvarez & Associates	11	$500,000.00	
Anacapa Micro Products	19	$9,600,000.00	
Blue Tech, Inc.	30	$18,000,000.00	1
C&C Int'l Computers and Consultants	73	$4,635,000.00	
FCN Inc.	28	$32,000,000.00	
FedStore Corp.	6	$3,000,000.00	2
Four Points Technology	22	$10,000,000.00	
FS Partners	not available	not available	
FS Vets	not available	not available	
Government Acquisitions	45	$184,200,000.00	
GovPlace	55	$85,600,920.00	
Green IT	not available	not available	
iGov Technologies	86	$124,488,400.00	
Impres Technologies	15	$21,835,992.00	3
MA Federal dba iGov	86	$124,488,400.00	
MCP Computer Products, Inc.	20	$15,000,000.00	
Merlin International	90	$159,000,000.00	
New Tech Solutions	20	$39,267,951.00	7
Patriot Comm	not available	not available	
Pci Tec	14	$27,000,000.00	4
Red River Computer Corp	130	$189,000,000.00	
SDV Solutions	52	$12,900,000.00	
SNAP, Inc.	100	$20,000,000.00	
Thundercat	15	$54,000,000.00	
Trofholz Technologies, Inc.	57	$23,600,688.00	

Unistar-Sparco	23	$22,827,042.00	5
Universal Understanding	5	$100,000.00	
Westwind Team	13	$59,000,000.00	
Wildflower Intl	44	$100,082,000.00	

Air Force NETCENTS-2 Awardees	NUMBER OF EMPLOYEES	ANNUAL REVENUE	Notes
Ace Technology Partners, LLC	40	$24,000,000.00	
Blue Tech, Inc.	30	$18,000,000.00	1
Counter Trade Products (CTP)	44	$32,000,000.00	
FCN Inc.	28	$32,000,000.00	
FedStore Corp.	6	$3,000,000.00	2
Force 3	149	$144,950,928.00	
Integration Technologies Group	83	$21,000,000.00	
M2 Technology	8	$7,800,000.00	
Micro Tech	3	$200,000.00	
Red River Computer Corp	130	$189,000,000.00	
Sterling Computers Corp	73	$20,000,000.00	6

NASA SEWP-V Awardees	NUMBER OF EMPLOYEES	ANNUAL REVENUE	Notes
4 Star Technologies	6	$24,446,950.00	
A&T Marketing, Inc.	6	$5,000,000.00	
AATD, LLC	5	$500,000.00	
Abba Technologies	34	$30,000,000.00	
ABM Federal Sales	60	$284,884,992.00	
Accelera Solutions	108	$35,003,916.00	
Accessagility, LLC	21	$1,000,000.00	
ACE Computers	40	$24,000,000.00	
ACE Technology Partners, LLC	40	$24,000,000.00	
Advanced Computer Concepts	45	$40,000,000.00	
Affigent	97	$151,655,216.00	
Akira Technologies	1	$250,000.00	
Akira Technologies, Inc.	11	$1,900,000.00	
All Points Logistics	120	$42,787,960.00	8
Alliance Technology Group	63	$22,000,000.00	

Alpha Six Corporation	not available	not available	
Alvarez & Assoc	11	$500,000.00	
American Wordata	10	$7,158,554.00	
Anacapa Micro Products	19	$9,600,000.00	
AS Global Corp	2	$200,000.00	
BAHFed Corporation	20	$200,000.00	
Better Direct	10	$4,200,000.00	
Blue Tech	30	$18,000,000.00	1
Capital Supply, Inc.	28	$21,324,140.00	
Carolina Advanced Digital, Inc. (CAD)	16	$7,000,000.00	
Cartridge Technologies, Inc. (CTI)	25	$3,900,000.00	
Chandler Automated Systems, Inc. dba Vigilant Technologies	9	$750,000.00	
Computer Marketing Associates, Inc.	12	$2,000,000.00	
Connected Workplace Solutions (CWPS), Inc.	not available	not available	
Convergence Technology Consulting, LLC (CTC)	55	$25,800,000.00	
Copper River Information Technology	134	$50,000,000.00	
Counter Trade Products (CTP)	44	$32,000,000.00	
CSP Enterprises	5	$3,500,000.00	
Cutting Edge Technologies & Solutions (CETECHS)	not available	not available	
Cynergy Professional Systems	1	$1,500,000.00	
DASNet Corporation	40	$11,000,000.00	
Direct Systems Support (DSS)	not available	not available	
DISYS Solutions, Inc.	45	$59,000,000.00	
DRS Technologies, Inc.	10	$130,860,008.00	
Dynamic Computer Corporation	21	$22,000,000.00	
Dynamic Systems, Inc.	36	$60,000,000.00	
Enterprise Technology Solutions, Inc. (ETSI)	not available	$4,100,000.00	
Epoch Concepts, LLC	7	$6,000,000.00	
Fastech, Inc.	24	$5,553,968.00	
FCN, Inc.	28	$32,000,000.00	
FedBiz IT Solutions, LLC	4	$500,000.00	
Federal Tech Solutions, Inc. (FTSI)	not available	not available	
FedStore Corp	6	$3,000,000.00	2
Force 3	149	$144,950,928.00	

Four Points Technology	22	$10,000,000.00	
Four, Inc.	not available	$86,859,482.00	9
GC Micro	30	$33,000,000.00	
GMC Tek, LLC	3	$130,000.00	
Government Acquisitions	45	$184,200,000.00	
GovPlace	55	$85,600,920.00	
GovSmart, Inc.	15	$36,688,056.00	
HMS Technologies, Inc.	35	$14,233,528.00	
Hyperion, Inc.	60	$7,392,351.00	
i3 Federal, LLC	6	$18,700,000.00	
Immix Technology, Inc.	162	$31,929,440.00	
Integration Technologies Group	83	$21,000,000.00	
ISSTSPi LLC	not available	not available	
Knowledge Information Solutions, Inc. (KIS)	27	$44,937,744.00	
Koi Computers, Inc.	6	$7,000,000.00	
Kpaul Properties	20	$3,000,000.00	
Lyme Computer Systems	28	$52,000,000.00	
M&A Technology, Inc.	80	$52,000,000.00	
M2 Technology	8	$7,800,000.00	
MA Federal dba iGov	86	$124,488,400.00	
MARSHALL Communication Corporation	23	$16,500,000.00	
MCP Computer Products, Inc.	20	$15,000,000.00	
Mercom, Inc.	75	$42,945,704.00	
Merlin International, Inc.	90	$159,000,000.00	
Micro Tech	3	$200,000.00	
Minburn Technology Group, LLC	5	$1,250,000.00	
MNQ Business Solutions, LLC	3	not available	
MVS, Inc.	15	$12,981,190.00	
NAMTEK Corporation	2	$1,700,000.00	
NCS Technologies, Inc.	120	$60,000,000.00	
New Tech Solutions (NTS)	25	$34,455,560.00	7
Norseman Defense Technologies	25	$54,000,000.00	
Northern Technologies Group (NTG)	30	$5,856,831.00	
OGIS Communications Group, Inc.	3	$795,000.00	

Optivor Technologies	33	$24,000,000.00	
Pci Tec	14	$27,000,000.00	4
Petrosys Solutions, Inc. (PSI) dba psitechnology	8	$6,000,000.00	
Phoenix Data Security, Inc.	4	$475,000.00	
Premier Technical Services Corp.	not available	not available	
Red River Computer	130	$189,000,000.00	
RedHawk IT Solutions, LLC	6	$1,530,334.00	
Regan Technologies Corp	15	$34,004,480.00	
Seeds of Genius	15	$9,000,000.00	
SMS Data Products Group, Inc. (SMS)	not available	not available	
Spectrum Systems	35	$45,000,000.00	
Sterling Computers Corp	73	$20,000,000.00	6
Storsoft Technology Corporation	5	$5,000,000.00	
Strategic Communications	29	$61,454,928.00	
Swish Data Corporation	21	not available	
Sword & Shield Enterprise Security, Inc.	27	not available	
Synergy Professional Systems, LLC	not available	not available	
Sysorex Government Services, Inc.	69	$11,387,170.00	
Techanax, LLC	4	$204,000.00	
Technician Professionals, LLC	27	$3,000,000.00	
Technology Solutions Provider, Inc. (TSPi)	18	$7,000,000.00	
ThreeWire Systems, LLC	20	$5,300,000.00	
Transource Services Corporation	33	$50,000,000.00	
Tribalco LLC	54	$124,586,691.00	10
Unistar-Sparco	23	$22,827,042.00	5
V3 Gate	not available	not available	
VAE, Inc.	40	$10,000,000.00	
Veteran Information Technologies, LLC (VIT)	23	$17,900,000.00	
Victory Global Solutions	20	$5,300,000.00	
Video & Telecommunications, Inc. (VTI)	6	$6,100,000.00	
Vology, Inc.	125	$78,666,664.00	
Walker and Associates	135	$99,631,560.00	
Westwind Team	13	$59,000,000.00	
Wildflower International	44	$100,082,000.00	

Zones, Inc.	not available	not available	

CIO-CS AWARDEES	NUMBER OF EMPLOYEES	ANNUAL REVENUE	Notes
Advanced Computer Concepts	45	$40,000,000.00	
Affigent	97	$151,655,216.00	
Akira Technologies, Inc.	11	$1,900,000.00	
Alvarez & Assoc	11	$500,000.00	
Anacapa Micro Products	19	$9,600,000.00	
Blue Tech	30	$18,000,000.00	1
CAS Severn, Inc.	94	$41,000,000.00	
Computer Marketing Associates, Inc.	12	$2,000,000.00	
Counter Trade Products (CTP)	44	$32,000,000.00	
DISYS Solutions, Inc.	45	$59,000,000.00	
Dynamic Systems, Inc.	36	$60,000,000.00	
En-Net Services	19	$24,000,000.00	
FCN, Inc.	28	$32,000,000.00	
FedStore Corp	6	$3,000,000.00	2
Four Points Technology	22	$10,000,000.00	
Futron Incorporated	37	$11,643,225.00	
Government Acquisitions	45	$184,200,000.00	
GovPlace	55	$85,600,920.00	
GovSmart, Inc.	15	$36,688,056.00	
Ideal System Solutions, Inc.	35	$23,979,274.00	
Impres Technologies	15	$21,835,992.00	3
Integration Technologies Group	83	$21,000,000.00	
iStor Solutions LLC (JV)	65	$15,000,000.00	
iT1 Source, LLC	68	$65,120,000.00	
Jeskell Systems, LLC	47	$850,000,000.00	
Koi Computers, Inc.	6	$7,000,000.00	
Lilien Systems	44	$45,712,368.00	
MA Federal, Inc.	86	$124,488,400.00	
MARSHALL Communication Corporation	23	$16,500,000.00	
Mercom, Inc.	75	$42,945,704.00	
New Tech Solutions (NTS)	25	$34,455,560.00	7

Norseman Defense Technologies	25	$54,000,000.00	
Pci Tec	14	$27,000,000.00	4
PCPC Direct Ltd.	70	$56,209,424.00	
Red River Computer	130	$189,000,000.00	
Spectrum Systems	35	$45,000,000.00	
Sterling Computers Corp	73	$20,000,000.00	6
Strategic Communications	29	$61,454,928.00	
Swish Data Corporation	21	not available	
Sword & Shield Enterprise Security, Inc.	27	not available	
Synergy Group (JV)	not available	not available	
ThreeWire Systems, LLC	20	$5,300,000.00	
Westwind Team	13	$59,000,000.00	

Sources: Federal Procurement Data System, www.fpds.gov; USASpending.gov where noted below.

Notes:

A. The above annual revenue figures reflect only revenues from Federal contracts and no revenue contracts from State/local government, or commercial contracts. Our experience indicates that these companies perform on mostly federal government contracts.

B. Yellow highlighted rows reflect those small ITVARs that will no longer qualify as small under NAICS Code 541519 if the Proposed Rule is finalized. This data suggest that a total of 51 companies of 119 on this list (with duplicates removed) will lose such status if the Proposed Rule is finalized, or **43%**. Individual contract percentages are as follows:

C. 17 of the DHS First Source awardees will no longer qualify, or 63% of those whose revenue is available.
D. 7 of the NETCENTS-2 awardees will no longer qualify, or 64% whose revenue is available.
E. 43 of the SEWP-V awardees will no longer qualify, or 41% whose revenue is available.
F. 27 of the CIO-CS awardees will no longer qualify, or 67.5% whose revenue is available.

1. Data actually provided by this company reflects current revenue at $175M and 42 employees
2. Data actually provided by this company reflects current revenue at $81.7M and 25 employees
3. Data actually provided by this company reflects current revenue at $72M and 23 employees
4. Data actually provided by this company reflects current revenue at $70.2M and 21 employees
5. Data actually provided by this company reflects current revenue at $42.6M and 29 employees

6. Data actually provided by this company reflects current revenue at $179.5M and 114 employees
7. New Tech Solutions has reported revenues of $117,803,854 for FY 12-FY 14 according to USASpending.gov.
8. All Points Logistics has reported revenues of $128,363,881 for FY 12-FY 14 according to USASpending.gov.
9. Four, LLC has reported revenues of $86,859,482 for FY 12-FY 14 according to USASpending.gov.
10. Tribalco LLC has reported revenues of $124,586,691 for FY 12-FY 14 according to USASpending.gov.

Other Sources:

http://www.dhs.gov/sites/default/files/publications/FirstSource%20II%20POC%20Info%20and%20E-mail%20List_1.pdf
http://www.netcents.af.mil/contracts/netcents-2/products/index.asp
https://www.sewp.nasa.gov/sewpv/
https://www.fbo.gov/utils/view?id=4b72526ba8bdf6acfc388b5b57938d6e