

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, Subcommittee on Investigations, Oversight and Regulations, Committee on Small Business

From: Committee Staff

Date: October 21, 2011

Re: Hearing: "Small Business Programs: Misrepresentation and Fraud in the Certification Process"

The Subcommittee on Investigations, Oversight and Regulations of the Committee on Small Business will meet on Thursday, October 27, 2011 in Room 2360 of the Rayburn House Office Building for the purposes of receiving testimony on fraud in the certifications and implementation of the small business procurement programs. Witnesses will include the Hon. Peggy E. Gustafson, Inspector General (IG), Small Business Administration (SBA), and the Hon. Brian D. Miller, Inspector General, General Services Administration (GSA).

I. Introduction

In Fiscal Year 2010, the federal government obligated approximately \$536 billion in prime contracts, which in turn resulted in approximately \$210 billion in subcontracts. Small businesses received over \$109 billion in prime contracts, and over \$74 billion in subcontracts. The hearing will address the small business certification process, and the misrepresentations and fraud schemes uncovered by the SBA and GSA IG investigations.

The Small Business Act (the Act) iterates Congress's belief in the importance of small business participation in federal prime contracts and the resultant subcontracts. Specifically, the Act directs that:

To effectuate the purposes of this Act, small-business concerns within the meaning of this Act shall receive any award or contract or any part thereof, and be awarded any contract for the sale of Government property, as to which it is determined by the Administration and the contracting procurement or disposal agency (1) to be in the interest of maintaining or mobilizing the Nation's

full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government in each industry category are placed with small-business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small-business concerns;

15 U.S.C. § 644(a).

To effectuate these objectives, Congress has enacted six different contract programs overseen by the SBA's Office of Government Contracting and Business Development. Each of these programs has a statutory goal associated with it, relating to the percentage of prime contract dollars the government should award qualifying firms each year. These programs are the small business contracting program, Historically Underutilized Business Zone (HUBZone) small business program, Woman-Owned Small Business (WOSB) program, 8(a) Business Development (8(a)) program, Small Disadvantaged Business (SDB) programs, and the Service-Disabled Veteran-Owned Small Business (SDVOSB) programs. Explanations of each of these programs, the applications processes, benefits and appeals may be found in Attachment A.

Fraud in the small business contracting results in three types of harms. First, there is the loss to small businesses. Legitimate small businesses are negatively impacted by bad actors who seek to take advantage of these programs. When contracts go to firms that do not qualify for, or who are not following the rules associated with, a contracting program, legitimate firms are denied the right to perform on a contract. Second, there is loss to the government. When false small businesses are receiving contracts, the government's statutory procurement goals are skewed. Bad actors also harm the reputations of legitimate small businesses, so contracting officers are more reluctant to use the SBA programs, which in turn results in less competition and a less vibrant industrial base. Finally, the American people suffer. Small businesses create two out of every three new jobs, so when contracts go to false small businesses, fewer jobs are created.

II. Problems of Misrepresentation and Fraud

A. Misrepresentations of Size

One of the most basic forms of fraud occurs when firms identify themselves as small when the firm is either other-than-small or does not qualify for the program. In some cases, the misrepresentation can be a good faith error. For example, a company may not understand that it could be affiliated with another firm based on identity of interest, such as the other firm being owned by a sibling. Thus, two unrelated businesses could be considered affiliated by SBA, and their combined receipts and employees could place them above the relevant size standard.¹ In other cases, the firm may be intentionally misrepresenting its size, or failing to understand the

¹ 13 C.F.R. § 121.103(f).

SBA requirements.² These firms will have all misrepresented their size in the SBA's Dynamic Small Business Search (DSBS) tool, the Central Contractor Registration (CCR) and in the Online Representations and Certifications Application (ORCA), and potentially when applying to one of the small business programs requiring SBA or third party certification.³

While protests by other firms, contracting officers (KOs) and SBA personnel to the Office of Hearings and Appeals (OHA) successfully prevent awards to some of these companies, there is rarely a consequence for misrepresentation. Previously, prosecution was rare because it was difficult to prove a loss to the government from the misrepresentation – if a contracting officer had already certified that the price was fair and reasonable, the Department of Justice (DOJ) was hard pressed to quantify the damages. However, the Small Business Jobs Act associated a presumption of loss with misrepresentation equal to the “total amount expended” on the contract or subcontract.⁴

Evidence of misrepresentation is generally garnered from the Federal Procurement Data System (FPDS), which each year reports that well-known other-than-small businesses received dollars as a small business. However, it is important to remember that when a firm certifies as small at the time of offer, it can continue to claim small status for the life of the award, even if it grows beyond small, unless the growth is due to mergers or to being acquired.⁵ Additionally, even if a firm states in ORCA that it is not small, KO error can lead to the KO entering the award data as an award to a small business. However, even with the addition of a presumption of loss, prosecutions have not been brought against bad actors.

B. Program Specific Misrepresentations

Like the issue of size misrepresentation, some firms misrepresent their eligibility to participate in a program, or their status as a program participant. While this is a problem for all of the programs, one of the best examples is drawn from a 2008 Government Accountability Office (GAO) report, where GAO was able to successfully certify four bogus firms, and easily identified ten firms in Washington, D.C. that did not meet the program requirements but still received over \$100 million in contracts.⁶ Likewise, GAO was able to obtain certification for one bogus 8(a) firm, although three other bogus applicants were rejected based on capacity rather than on their fraudulent status, and GAO found 14 firms received \$325 million in set-aside and sole-source contracts through the 8(a) program even though the firms were not eligible for the 8(a) program.⁷

² In all fairness, the SBA affiliation rules are not always intuitive, and SBA's website does not warn small businesses of the affiliation rules. *See, e.g.*, SBA, “Am I a Small Business Concern” at <http://www.sba.gov/content/am-i-small-business-concern>, which does not reference affiliation.

³ <http://dsbs.sba.gov>; www.ccr.gov and www.bpn.orca.gov.

⁴ 15 U.S.C. § 632(w), 124 Stat. § 2504, 2543.

⁵ 13 C.F.R. § 121.404.

⁶ GAO, HUBZONE PROGRAM: SBA'S CONTROL WEAKNESSES EXPOSED THE GOVERNMENT TO FRAUD AND ABUSE, (2008) (GAO-08-964T).

⁷ GAO, 8(A) PROGRAM: FOURTEEN INELIGIBLE FIRMS RECEIVED \$325 MILLION IN SOLE-SOURCE AND SET-ASIDE CONTRACTS, (20010) (GAO-10-425).

To address these problems, there is now a presumption of loss when firms engage in this type of conduct. Additionally, for the 8(a) and HUBZone programs, a firm can only be listed in CCR as a participant if they have been certified by SBA, but this certification does not necessarily indicate that the firm is meeting the program requirements. In self-certification programs, the possibility of abuse is even higher – for example, GAO also “identified 10 case-study examples of firms that did not meet SDVOSB program eligibility requirements [but which] received approximately \$100 million in SDVOSB contracts, and over \$300 million in additional dollars of 8(a), HUBZone, and non-SDVOSB federal government contracts.”⁸ The WOSB program has only been operational since April, 2011, so it is too soon to point to issues of misrepresentation, but given that many firms are certified by submitting documents to an unmanned repository and then relying on KOs to suss out eligibility, there remains a significant potential for misrepresentations.

C. Pass-Through Contracts

When a small business receives a set-aside or sole-source contract under one of the contracting programs, the government has a vested interest in ensuring that the small business performs a significant portion of the work. Otherwise, the small business could pass through the work to a large contractor. Consequently, Sections 3(p)(A)(i)(III), 8(a)(14) and 15(o) of the Small Business Act each impose restrictions on the amount of work a business may subcontract on a set-aside contract, generally requiring that the small firm perform 50 percent of the cost of the labor or the cost of manufacturing.⁹ These rules are complicated even for small businesses making a good faith effort to comply, since they rely on cost-based accounting, and require the small business to know its subcontractors’ costs. However, the cases that concern the Subcommittee are those where the firm is not making a good faith effort to comply with these requirements.

Last year, a *Washington Post* exposé drew attention to some of these cases. In one instance, it was revealed that the large subcontractor, a firm called GTSI, would “lead the work and receive 99.5 percent of the revenue, even though it was a subcontractor and MultimaxArray was the ‘prime.’”¹⁰ In another, a large firm negotiated to receive 75 percent of the profits on over \$166 million in set-aside task orders under a Department of Homeland Security indefinite delivery, indefinite quantity (ID/IQ) contract, and SBA later found that the small business prime contractor “had little to no involvement in the performance of contracts.”¹¹ Likewise, US2, a small business with only \$73,000 in revenue and run from the owner’s living room, was awarded an Army sole-source contract for \$250 million.¹²

⁸ GAO, SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM: CASE STUDIES SHOW FRAUD AND ABUSE ALLOWED INELIGIBLE FIRMS TO OBTAIN MILLIONS OF DOLLARS IN CONTRACTS, 4-5 (2010) (GAO-10-108).

⁹ 15 U.S.C. § 644(o).

¹⁰ Robert O’Harrow, *In Deals between Alaska Corporation and D.C. Area Contractor, a Disconnect*, WASHINGTON POST, October 1, 2010, available at <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/30/AR2010093007348.html?sid=ST2010092907225>.

¹¹ Letter from Michael Chodos, Suspension and Debarment Official, SBA, to Scott W. Friedlander, President and Chief Executive, GTSI Corporation (October 10, 2011) available at <http://www.govexec.com/pdfs/100510rb1b.pdf>.

¹² Robert O’Harrow, *Audit: Army, Interior Broke Law by Awarding Contract to Alaska Native Corporation*, WASHINGTON POST, August 17, 2011.

The appropriate agency officials have tried to respond to these cases. The Department of Interior (DOI) IG found that “US2 has been non-compliant with 8(a) subcontracting limitations for more than 2 1/2 years” but that the contracting officer “did not take effective actions to either correct the problem or terminate the contract for non-compliance.”¹³ In the fall of 2010, SBA responded by suspending three companies from federal contracting due to violations of the limitation on subcontracting provisions.

Despite SBA’s recent attempts pursue bad actors with suspension, the issue remains that tracking compliance with the limitation on subcontracting provisions is complicated, time consuming, and bears little advantage for the typical KO. If a KO wanted to track compliance, the KO would need cost data from the prime contractor and each of the subcontractors. The contracting officer would then need to calculate the applicable percentages, and repeat this process at each option, or in the case of an ID/IQ contract, every six months.¹⁴ However, even if the KO determines a violation of the limitation on subcontracting clause present in each set-aside or 8(a) sole source contract,¹⁵ the KO would need to prove that the pass through of work harmed the government before most agencies take action against the companies. However, since the KO would have already determined that the government was paying a fair and reasonable price before awarding the contract, it would be nearly impossible to prove a financial harm to the government.

D. Nonmanufacturer Rule

Much like the limitation on subcontracting provision, the government also has a vested interest in ensuring that products sold by small businesses are actually produced by small businesses. Hence, when the government purchases more than \$25,000 in manufactured items through a set-aside or sole-source contract based on one of the aforementioned programs, the awardee must certify that it is manufacturing the product itself, or it must meet one of three exemptions.¹⁶ First, the firm can qualify as a nonmanufacturer if it has fewer than 500 employees, is primarily engaged in retail or wholesale business, and will instead supply the end item of a small business.¹⁷ Second, the firm can sell a nonmanufactured product if the KO determines for that procurement, or SBA determines universally, that “no small business manufacturer or processor reasonably can be expected to offer a product meeting the specifications.”¹⁸ Finally, when selling kits of supplies and goods, a small business only needs to ensure that 50 percent of the total value of manufactured items were manufactured by domestic small businesses.¹⁹ However, enforcement of this requirement remains problematic, and in the last year, SBA’s IG has found several instances of SBA itself violating the rule.²⁰ Again, there are presumptions of loss, so damages in these cases are hard to prove.

¹³ DOI OIG, ACQUISITION SERVICES DIRECTORATE—SIERRA VISTA, 5 (2011) (ER-IS-NBC-0003-2011).

¹⁴ 13 C.F.R. § 124.510(c).

¹⁵ *See, e.g.*, 48 C.F.R. § 52.217-1.

¹⁶ 13 C.F.R. § 121.406(a).

¹⁷ *Id.* at § 121.406(b).

¹⁸ *Id.* at § 121.406(b)(3)(i).

¹⁹ *Id.* at § 121.406(c).

²⁰ Memorandum from Debra S. Ritt, SBA Assistant IG for Auditing, to Daryl Hairston, SBA Associate Administrator for Management and Administration, SBA’s Planning and Award of the Customer Relationship

E. North American Industrial Classification System (NAICS) Shopping

Each government contract set aside under one of the aforementioned programs has a NAICS code assigned to it which is intended to best capture the nature of the requirement.²¹ To qualify for a procurement, the company must then be below the attendant size standard assigned to that NAICS code.²² However, KOs will assign a NAICS code with a larger or smaller size standard to expand or limit the number of companies eligible to participate, a practice known as NAICS shopping. Thus, a procurement that should be restricted to companies with annual receipts under \$25 million, such as computer-related services, will be assigned to the telecommunication NAICS code with its size standard of 1,500 employees. The NAICS may also be assigned to ensure that the nonmanufacturer or limitation on subcontracting rule does not apply.²³ A company is allowed to protest the NAICS assigned to the contract to OHA, but there are no penalties for KOs assigning inappropriate NAICS.²⁴ This practice allows the government to take credit for awarding contracts to small businesses, while forcing legitimate small businesses to compete against larger contractors.

F. Bribery and Kickbacks

While not strictly a small business issue, recent events make a discussion of bribery and kickbacks appropriate. On October 4, 2011, two government employees and two contractor employees were arrested in a \$20 million bribery and kickback scheme uncovered by the SBA IG and the Federal Bureau of Investigations (FBI). The indictments allege that an ANC 8(a) firm was receiving task orders against a \$1.3 billion Army Corps of Engineers (ACE) contract, passing most of the work and funds to another company (Company A). At least one employee of Company A would submit fraudulent inflated invoices, which at least one employee of the ANC 8(a) approved and submitted to the government. Two ACE employees approved the invoices, and the contracting officer paid the inflated costs. At that time, the bad actors at Company A used \$18 million of the inflated costs to bribe the two ACE employees, and the remaining \$2 million was split between bad actors at the ANC 8(a) and Company A.²⁵

Management Contracts (Jun. 29, 2010) available at <http://www.sba.gov/office-of-inspector-general/872/5203> (also indicates a violation of limitation on subcontracting clause); Memorandum from Peter L. McClintock, SBA Deputy IG, to Jon I. Carver, SBA Chief Financial Officer, Audit on SBA's Procurement of Information Technology Hardware and Software through Isika Technologies, Inc., Project No. 10018 (Feb 25, 2011) [hereinafter Isika] available at <http://www.sba.gov/content/11-08-sbas-procurement-information-technology-hardware-and-software-through-isika-technologies-inc> (contract violates nonmanufacturer rule, improperly used 8(a) program by splitting requirement to avoid dollar thresholds, and used the wrong size standard).

²¹ 13 C.F.R. § 121.402.

²² *Id.*

²³ Isika.

²⁴ 13 C.F.R. § 121.402.

²⁵ Press Release, DOJ, Two U.S. Army Corps of Engineers Employees and Two Others Indicted in \$20 Million Bribery and Kickback Scheme Involving Government Contracts (Oct. 4, 2011) (on file with the Committee).

III. Penalties

A. Loss of Contract

If SBA determines that a firm does not meet the program or size requirements before a contract is awarded, the company cannot be awarded the contract under the program. However, in some cases the agency will simply move the procurement from being a set-aside to full and open competition, or a sole source under the auspices of a non-small business program.²⁶ Conversely, the government has the ability to terminate a contract for default due to “the contractor’s actual or anticipated failure to perform its contractual obligations,”²⁷ but this penalty has not been used for misrepresentation of program eligibility or size, as the contractor is still performing the work at a fair and reasonable price and the termination itself incurs reprocurement costs. Likewise, the government always has the ability to terminate the contract for its own convenience, but by doing so it would need to pay the contractor’s termination costs as well as the reprocurement costs.²⁸

B. Suspension and Debarment

Suspension means temporarily prohibiting a contractor from seeking or being awarded new contracts pending the completion of investigation and any ensuing legal proceedings; whereas debarment is the prohibition on seeking contracts for a fixed period of time. Both penalties are permitted when a contractor is suspected or confirmed to have committed fraud or a criminal offense to obtain, attempt to obtain, or perform a government contract or subcontract.²⁹ Two small businesses have been suspended for failing to follow the limitation on subcontracting provisions,³⁰ and suspension for bribery or kickbacks is routine, but the Committee is unaware of any suspension actions related to the other types of small business fraud and misrepresentation.

C. Statutory Penalties

As previously mentioned, the Small Business Jobs Act associated a presumption of loss with misrepresentation equal to the “total amount expended” on the contract or subcontract.³¹ SBA published the proposed implementing rule on October 7, 2011, with comments due by November 7, 2011.³² Consequently, it is too early to know whether the change will have the intended result, but small businesses have expressed concerns that implementation does not allow for a good faith exception or any type of safe harbor.

²⁶ See, e.g., *Size Appeal of SIGA Technologies, Inc.*, SBA No. SIZ-5201 (2011), Department of Health and Human Services, Notice of Award to Siga Technologies, Solicitation Number: RFP-11-100-SOL-00007 (May 25, 2011).

²⁷ 48 C.F.R. § 49.4.

²⁸ *Id.* at § 49.2-3.

²⁹ *Id.* at § 9.4.

³⁰ www.epls.gov, see files for EG Solutions and MultiMaxArray.

³¹ 15 U.S.C. § 632(w), 124 Stat. § 2504, 2543.

³² 76 Fed. Reg. 62,313 (Oct. 7, 2011).

D. False Claims Act

Violations of the False Claims Act may be prosecuted civilly or criminally.³³ The civil False Claims Act imposes penalties on anyone who:

- (A) knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval;
- (B) knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim;
- (C) conspires to commit a violation of subparagraph (A), (B), (D), (E), (F), or (G); [or]
- (G) knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government,

37 U.S.C. § 3729.

While the Attorney General may bring civil suit, individuals may also bring actions under qui tam provisions, which allow the private party, or relator, to prosecute the case on behalf of the government and retain 15 to 25 percent of the monies recovered.³⁴ Qui tam actions are often brought by whistleblowers, and the government has the right to join and take control of such suits, or leave them to the relator.³⁵ Penalties are between \$5,500 and \$11,000 per violation,³⁶ “plus 3 times the amount of damages which the Government sustains because of the act.”³⁷ Criminal False Claims Act liability attaches when someone presents the federal government with a claim, “knowing such claim to be false, fictitious, or fraudulent.”³⁸ Such cases may only be brought by the government, and incur penalties of up to 5 years imprisonment plus monetary fines.³⁹

ORCA specifically advises potential contractors that misrepresentations within the system carry False Claims Act liability. To date, False Claims Act cases have not been brought based on size or program misrepresentation, usually because the cost of prosecution outweighs the monies that would be recovered.

³³ 37 U.S.C. § 3730; 18 U.S.C. § 287.

³⁴ *Id.* at § 3730(c).

³⁵ *Id.* at § 3730 (d).

³⁶ 28 C.F.R. § 85.3

³⁷ 37 U.S.C. § 3729(a).

³⁸ 18 U.S.C. § 287.

³⁹ *Id.*

E. Program Fraud Civil Remedies Act

The Program Fraud Civil Remedies Act⁴⁰ establishes an administrative remedy for false statements when the harm to the government is less than \$150,000. In such cases, liability attaches when an individual or concern makes or submits a claim that the individual knows or has reason to know is false, even if the falsehood is due to the omission of a material fact.⁴¹ If the Administrative Law Judge confirms the agency's assertion of fraud, penalties are \$5,000 plus twice the damages to the government or the amount of the claim.⁴² While this type of remedy seems ideally suited to the smaller claims frequently involved in misrepresentation, SBA does not routinely pursue Program Fraud Civil Remedies for size or program fraud, nor do the other agencies pursue it for the other types of fraud enumerated in this memorandum.

IV. Issues before the Subcommittee

A. Monitoring Mechanisms

Given the importance of integrity in the small business contracting programs, the Subcommittee must consider whether there are the correct monitoring mechanism in place to detect fraud and misrepresentation. While there simply are not the financial resources to certify the over 350,000 businesses registered in DSBS, are there mechanisms that would allow more selective reviews of potentially fraudulent businesses. For example, since FPDS already captures data on the value of prime contracts awarded to small businesses, could FPDS be set up to trigger DSBS when the prior three years receipts put a firm above a receipt-based size standard? This system would be admittedly imperfect, as it would not capture commercial contracts or employee-based size violations, but it would make use of data already readily available to the government to highlight potential fraud.

Similarly, in the programs where certification is required, do the IGs believe enough is being done to catch fraud in applications? The various GAO reports previously mentioned suggest that it is not difficult to receive a certification from SBA even if the firm is fictitious. The Subcommittee is also interested in the witnesses views on using KOs as the primary gatekeepers in the WOSB program, and whether KOs have the necessary background and time to investigate organizational structures.

For the types of fraud that are not size- or eligibility-based but instead related to the performance of the contract, such as limitations on subcontracting and the nonmanufacturing rule, the issues raised address cooperation between the SBA and other agencies, and the willingness of other agencies to enforce the program requirements. In March 2011, the SBA IG found that SBA's primary method of enforcement, the Surveillance Review Program, was "superficial, limited in scope, poorly documented, and untimely, and [was therefore] inadequate for making determinations about the effectiveness of the contracting activities' small business programs or

⁴⁰ 31 U.S.C. § 3801-3812.

⁴¹ *Id.* at § 3801.

⁴² *Id.* at § 3801(a)(1).

their compliance with small business rules.”⁴³ SBA failed to look for pass throughs’ misapplication of size standards, or the use of ORCA to verify size.⁴⁴ In the 8(a) program, which is primarily sole-source contracts, SBA failed to review if the agencies were appropriately applying the delegation of authority to enter into contracts without involving SBA personnel.⁴⁵

Likewise, the Subcommittee is concerned with whether personnel at GSA and other agencies have adequate training on the small business programs to understand and detect fraud, and question if the electronic tools available adequately assist with this detection.⁴⁶ Therefore, the Subcommittee hopes the witnesses will address the results of these reports and recommendations to improve monitoring and strengthen internal controls.

B. Enforcement Mechanisms

Even when fraud or misrepresentation is detected, it is the exception rather than the rule to have the offender face one of the aforementioned penalties. The Subcommittee wishes to learn what changes could be made to increase use of suspension, debarment, specific statutory penalties, False Claims Act, and Program Fraud Civil Remedies Act in order to protect legitimate small businesses. For example, the Subcommittee questions why SBA does not have a standard operating procedure for suspension and debarment. Furthermore, before the presumption of loss rules will have a deterrent effect, the KOs must understand them and understand the importance of enforcement. To that end, the Subcommittee hopes the witnesses will address the sufficiency of current guidance on the roles and responsibilities for each program, and the robustness of current enforcement procedures.

V. Conclusion

In order for the small business programs to accomplish their statutory goals of promoting a healthy industrial base and increasing competition, particularly among small firms, the programs must operate in a transparent manner that minimizes the risk of fraud and misrepresentation. In doing so, this will free legitimate small business to innovate, create jobs, and increase competition.

⁴³ SBA IG, EFFECTIVENESS OF THE SBA’S SURVEILLANCE REVIEW PROCESS, 4 (2011) (SBA IG 11-11). The report criticized samples sizes, choice of activities to review, compliance with standard operating procedures, and scope of reviews.

⁴⁴ *Id.* at .9.

⁴⁵ *Id.* at .10.

⁴⁶ The tools include the Federal Subcontracting Reporting System, which is intended to track all subcontract awards, and which could be used to monitor compliance with limitations on subcontracting, and FPDS.

Attachment A

A. The Small Business Prime Contracts Program.

According to the Act, a small business concern is one that is independently owned and operated, organized for profit, and which is not dominant in its field of operations.⁴⁷ SBA creates specific size standards for each industry, and assigns revenue- or employee-based size standards⁴⁸ to each of the more than 1,100 North American Industrial Classification System (NAICS) codes.⁴⁹ Contracts can be set-aside for small businesses in two ways. First, all contracts below \$150,000 are reserved for small businesses unless the contracting officer (KO) determines there is not a reasonable expectation of obtaining offers from two or more firms.⁵⁰ Second, any contract over \$150,000 should be set aside for small business if the KO determines that at least two small businesses will make offers, and award can be made a fair price.⁵¹ The business certifies that is small at the time of offer⁵² through the Online Representations and Certifications Application⁵³ (ORCA). If an offeror or the KO believes that the successful bidder is not actually a small business, SBA's size specialists and Office of Hearings and Appeals (OHA) will adjudicate the firm's size.⁵⁴ There is a goal of awarding at least 23 percent of all federal prime contract dollars to small businesses, and SBA creates a goal for subcontracts.⁵⁵

B. The Historically Underutilized Business Zone (HUBZone)⁵⁶ Program.

HUBZone small business concerns are small businesses whose principle office is located in a HUBZone, that are at least 51 percent owned by United States citizens, and which draw at least 35 percent of their employees from HUBZones.⁵⁷ These firms can receive set-aside contracts if two or more HUBZone concerns are expected to make a fair and reasonable offer.⁵⁸ Sole-source

⁴⁷ 15 U.S.C. § 632(a).

⁴⁸ In a few instances, other factors are also considered, such as production or assets. *Id.*

⁴⁹ 13 C.F.R. § 121. These regulations also provide SBA's affiliation standards, which address the independence of operations.

⁵⁰ 48 C.F.R. § 19.502-2(a).

⁵¹ *Id.* at (b).

⁵² 13 C.F.R. § 121.404.

⁵³ available at www.bpn.orca.gov.

⁵⁴ 13 C.F.R. § 121.1001.

⁵⁵ 15 U.S.C. § 644(g)(1).

⁵⁶ HUBZone are defined as any area located in a qualified census tract, qualified nonmetropolitan county, within the external boundaries of an Indian reservation or an area subject to the Base Realignment and Closure Act (BRAC). 15 U.S.C. § 632(p). Qualified census tracts are tract designated by the Department of Housing and Urban Development (HUD) in which either 50 percent or more of the households have an income which is less than 60 percent of the area median gross income for such year or which has a poverty rate of at least 25 percent, but no more than 20 percent of a metropolitan statistical area may qualify. 26 U.S.C. § 42(d)(5)(B)(ii). Qualified nonmetropolitan counties are those in which median household income is at less than 80 percent of the nonmetropolitan State median household income, the unemployment rate at least 140 percent of the average unemployment rate for the United States or for the State in which such county is located, whichever is less, or which is located in a difficult development area, as designated by HUD. 15 U.S.C. § 632(p).

⁵⁷ 15 U.S.C. § 632(p)(5).

⁵⁸ 48 C.F.R. § 19.1305-1307.

awards are permitted for contracts below \$4 million (\$6.5 million for manufacturing contracts).⁵⁹ A price evaluation adjustment of 10 percent is granted when bidding on contracts offered through full and open competition.⁶⁰ To certify as a HUBZone firm, a small business must apply on the SBA website, recertify every three years, certify through ORCA, and qualify at the time of offer and the time of award.⁶¹ SBA has the authority to conduct program examinations of firms to verify their continued eligibility⁶² or to hear appeals of regarding a firm's size⁶³ or eligibility for the program.⁶⁴ There is a goal of awarding three percent of all prime contract dollars and three percent of all subcontract dollars to HUBZone firms.⁶⁵

C. The Small Disadvantaged Business (SDB) and the 8(a) Business Development (8(a)) Programs.

SDBs are small businesses at least 51 percent unconditionally owned by one or more socially and economically disadvantaged individuals.⁶⁶ Social disadvantage is presumed for members of designated groups, or may be established by a preponderance of the evidence for any other individual.⁶⁷ Economic disadvantage is defined as a net worth of less than \$750,000, after excluding the value of the individual's ownership interest in the small business and the value of the individual's equity in a primary personal residence.⁶⁸ A firm certifies as a SDB to either the procuring agency or to a third-party certifier, although all 8(a) firms are automatically considered SDBs.⁶⁹ There is a statutory goal of awarding five percent of all prime contract and five percent of all subcontract dollars to SDBs.⁷⁰

The 8(a) program is an important subset of the SDB program. 8(a) firms are small businesses owned and controlled by socially and economically disadvantaged individuals who have applied for and been accepted into a nine-year business development program at SBA.⁷¹ While the definition of social disadvantage is the same in the 8(a) program as it is in the SDB program, the definition of economic disadvantage is much stricter, with a \$250,000 cap on assets outside of

⁵⁹ 48 C.F.R. § 19.1305-1307.

⁶⁰ 48 C.F.R. § 19.1305-1307.

⁶¹ 13 C.F.R. § 126.300.

⁶² *Id.* at § 126.401.

⁶³ *Id.* at § 121.1001.

⁶⁴ SBA, the KO, or any other interested party may protest the apparent successful offeror's qualified HUBZone SBC status. 13 C.F.R. § 126.801.

⁶⁵ 15 U.S.C. § 644(g)(1).

⁶⁶ 13 C.F.R. § 124.1002.

⁶⁷ There is a rebuttable presumption that "Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans (persons with origins from Burma, Thailand, Malaysia, Indonesia, Singapore, Brunei, Japan, China (including Hong Kong), Taiwan, Laos, Cambodia (Kampuchea), Vietnam, Korea, The Philippines, U.S. Trust Territory of the Pacific Islands (Republic of Palau), Republic of the Marshall Islands, Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, Guam, Samoa, Macao, Fiji, Tonga, Kiribati, Tuvalu, or Nauru); Subcontinent Asian Americans (persons with origins from India, Pakistan, Bangladesh, Sri Lanka, Bhutan, the Maldives Islands or Nepal)" are socially disadvantaged. 13 C.F.R. § 124.103.

⁶⁸ 13 C.F.R. § 124.1002(c).

⁶⁹ *Id.* at § 124.1003.

⁷⁰ 15 U.S.C. § 644(g)(1).

⁷¹ 13 C.F.R. § 124.

the business and primary residence, and a requirement that the individual demonstrate a limited access to capital.⁷² Participation in the 8(a) program provides important contracting preferences – sole-source contracts up to \$4 million (\$6.5 million for manufacturing contracts) are the preferred contracting method, although competitive 8(a) awards are allowed with the permission of the SBA.⁷³ In the 8(a) program, SBA is considered the prime contractor, and the 8(a) firm is its subcontractor, which requires agencies to negotiate awards with SBA.⁷⁴ However, since the 1990s, SBA has been entering into Memorandums of Understanding (MOUs) with agencies, allowing agencies to bypass SBA and award contracts directly to the 8(a) firms.⁷⁵ The 8(a) certification is processed by SBA, and annual reviews are required throughout the nine years to ensure a firm’s continued eligibility.⁷⁶

Concerns owned by Indian Tribes (ITs) and Alaska Native Corporations (ANCs) may qualify for a modified version of the 8(a) program. ITs and ANCs are not required to be involved in the day-to-day management of the participant.⁷⁷ ANCs are presumed economically disadvantaged,⁷⁸ whereas ITs look at the economic status of the tribe as a whole and apply different thresholds.⁷⁸ In neither case is the size of other concerns owned by the ANC or IT considered when determining if the firm is small, and ANCs and ITs may have multiple subsidiaries participating in the 8(a) program at the same time. Perhaps the most important distinction is that ANCs and ITs are not subject to any caps on the size of sole-source contracts, although there is a proposed regulation to require that KOs justify sole-source awards above \$20 million.⁷⁹

Unlike the HUBZone or small business program, the eligibility of an 8(a) participant cannot be challenged by another 8(a) firm or any other party.⁸⁰ The size of the firm may be challenged to the Office of Hearings and Appeals by the SBA, KO or an interested party, but not if the size is being challenged as pursuant to a sole source award.⁸¹

D. The Women-Owned Small Business (WOSB) and Economically Disadvantaged Women-Owned Small Business (EDWOSB) Programs.

WOSB are small businesses that are at least 51 percent owned and controlled by women who are United States citizens.⁸² EDWOSB must meet the same eligibility requirements, and demonstrate that they have a personal net worth of less than \$750,000, exclusive of a primary residence, the ownership share in the business, and any retirement accounts that have penalties for early withdrawal.⁸³ To certify as a WOSB or EDWOSB, the firm must register as such in the

⁷² *Id.* at § 124.104.

⁷³ *Id.* at § 124.506.

⁷⁴ 15 U.S.C. § 637(a).

⁷⁵ 13 C.F.R. § 124.508.

⁷⁶ *Id.* at § 124.201, 124.601.

⁷⁷ *Id.* at § 124.109.

⁷⁸ *Id.*

⁷⁹ Federal Acquisition Regulation; Justification and Approval of Sole-Source 8(a) Contracts, 76 Fed. Reg. 14,559 (Mar. 16, 2011) (to be codified at 48 C.F.R. § 6, § 8, and § 19).

⁸⁰ 13 C.F.R. § 124.517.

⁸¹ *Id.*

⁸² *Id.* at § 127.200.

⁸³ *Id.* at § 127.203.

Central Contractor Registration (CCR), certify in ORCA, and provide the KO with supporting documents.⁸⁴ Additionally, the firm must either be certified by an SBA-approved third party certifier or provide supporting documentation to the Program Repository.⁸⁵ Contracts may be set aside for EDWOSB if: (1) the contract requirement is in an industry designated by SBA as one where WOSB are underrepresented; (2) two or more EDWOSBs will submit offers for the contract; and (3) award of the contract may be made at a fair and reasonable price that is less than \$5 million if the contract is for manufacturing, or less than \$3 million in all other cases.⁸⁶ Contracts may be set aside for WOSB in the same manner, except that the contract requirement must be for an industry designated by SBA as one where WOSB are substantially underrepresented.⁸⁷ Status as an EDVOSB or a WOSB may be protested by another EDVOSB or WOSB bidding on a specific requirement, by the KO, or by SBA.⁸⁸ There is a goal of awarding five percent of all prime contract dollars and five percent of all subcontract dollars to WOSB.⁸⁹

E. The Service-Disabled Veteran-Owned Small Business (SDVOSB) Program.

SDVOSBs are small businesses that are at least 51% percent owned and controlled by service-disabled veterans, or the spouse or caregiver of a service-disabled veteran with a permanent and severe disability.⁹⁰ Contracts may be set aside for SDVOSB if there are two or more SDVOSB who will submit offers and the award can be made at a fair and reasonable price.⁹¹ SDVOSB may receive sole-source contract if there is only one SDVOSB who can meet the requirements at a fair and reasonable price, and the contract will not exceed \$6 million for a manufacturing contract or \$3.5 million for any other contract.⁹² For purposes of contracting with any agency other than the Department of Veterans Affairs (VA), a concern must certify its status in ORCA, and is subject to protest by other interested parties, the KO, or the SBA.⁹³ If the firm wishes to contract with VA, it must have its eligibility verified by VA.⁹⁴ There is a goal of awarding three percent of all prime contract dollars and three percent of all subcontract dollars to SDVOSB.⁹⁵

⁸⁴ *Id.* at § 127.300. The supporting documents include (1) proof of citizenship; (2) joint venture agreements; (3) Articles of organization and operating agreements for Limited Liability Companies; (4) Articles of incorporation by-laws, stock certificates, stock ledger and voting agreements for corporations; (5) for partnerships, the partnership agreement and any amendments; (6) any assumed/fictitious name certificate(s); (7) a signed copy WOSB/EDWOSB program certification; and (8) for EDWOSBs, personal financial statements.

⁸⁵ *Id.*

⁸⁶ *Id.* at § 127.503(a).

⁸⁷ *Id.* at § 127.503(b).

⁸⁸ *Id.* at § 121.1001(a)(9).

⁸⁹ 15 U.S.C. § 644(g)(1).

⁹⁰ 13 C.F.R. § 1215.8.

⁹¹ 48 C.F.R. § 19.1405(b).

⁹² *Id.* at § 19.1406(a).

⁹³ 13 C.F.R. § 125.25.

⁹⁴ 38 C.F.R. § 74. Interestingly, this has led to cases where VA and SBA have conflicting determinations regarding who controls the business.

⁹⁵ 15 U.S.C. § 644(g)(1).