

**Congress of the United States**  
**U.S. House of Representatives**  
**Committee on Small Business**  
2361 Rayburn House Office Building  
Washington, DC 20515-6515

To: Members, Subcommittee on Contracting and the Workforce, Committee on Small Business  
From: Committee Staff  
Date: March 16, 2015  
Re: Hearing: "Contracting and the Industrial Base II: Bundling, Goaling, and the Office of Hearings and Appeals"

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The Committee on Small Business Subcommittee on Contracting and the Workforce will meet for a hearing titled, "*Contracting and the Industrial Base II: Bundling, Goaling, and the Office of Hearings and Appeals.*" The hearing is scheduled to begin at **10:00 A.M. on Tuesday, March 17, 2015 in Room 2360 of the Rayburn House Office Building.**

As discussed during the February 12, 2015 Small Business Committee hearing "*Contracting and the Industrial Base,*" while the percentage of dollars awarded to small businesses has been increasing over the past four years, the participation of small businesses in declining. This reflects that fewer small businesses are winning contracts, but those contracts are worth more, which may indicate a weakness in the industrial base. To continue examining this topic, this hearing will examine issues related to: 1) bundling, consolidation, and strategic sourcing; 2) the Small Business Administration's (SBA) goaling methodology and processes; and 3) the jurisdiction and operation of SBA's Office of Hearings and Appeals (OHA).

**I. Executive Summary**

**a. Contract Bundling**

As discussed in Section II, unjustified contract bundling and consolidation remain among the greatest challenges for small businesses wishing to compete in the federal marketplace. When several separate, smaller contracts are combined into one unnecessarily large contract, it keeps small businesses from even submitting an offer, which limits competition. While in some cases the benefits of bundling and consolidation justify this procurement strategy, in others it simply limits competition to the detriment of small firms. The Federal Strategic Sourcing Initiative (FSSI), Category Management, and other executive branch initiatives continue to promote bundling and consolidation. While dollars awarded to small businesses under these initiatives have increased, the number of small businesses allowed to compete for federal work has decreased dramatically, making contract bundling a key issue in the health of the industrial base.

## **b. Goaling**

As discussed in Section III, SBA reports annually to Congress on the small business accomplishments during the prior year, but the Subcommittee is concerned that the report does not accurately reflect whether the federal government is meeting the small business goals. This section will discuss those goals, SBA's scorecard methodology, and the discrepancies between the two. Finally, it will examine whether SBA's goals are inadvertently creating incentives to consolidate contracts, apply the wrong size standard to contracts, and ignore subcontracting opportunities for small businesses.

## **c. Office of Hearings and Appeals**

As discussed in Section IV, the SBA's OHA is an independent administrative tribunal at SBA that hears appeals of SBA program determinations and appeals of contracting officer-designated North American Industry Classification System (NAICS) codes. This section will first discuss putting OHA in statute to assure its full independence from SBA. Second, it will discuss issues with respect to NAICS appeals, particularly the "NAICS shopping," an unforeseen consequence that arose from OHA's denial of standing to large firms. Finally, it will discuss SBA's improper promulgation of regulations with respect to size standards and explore the potential for allowing firms to challenge such regulations at OHA.

## **II. Contract Bundling**

The Small Business Act (the Act) defines contract bundling as "consolidating 2 or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small-business concern," but it defines a consolidated contract as one that satisfies "2 or more requirements of the Federal agency for goods or services that have been provided to or performed for the Federal agency under 2 or more separate contracts lower in cost than the total cost" of the new contract.<sup>1</sup> Under bundling, a contract may be unsuitable for award to a small business due to the "the diversity, size, or specialized nature of the elements of the performance specified;" the value of the contract, places of performance, or a combination of these factors.<sup>2</sup> The key distinction between contract bundling and contract consolidation is that consolidation does not require a finding that a contract will not be suitable for award to small business. Therefore, a contract may be consolidated but not bundled, but all bundled contracts are consolidated.

The Committee has a long history of oversight with respect to contract bundling. Throughout several Congresses, the Committee has held a number of hearings on contract bundling, submitted letters objecting to various procurement strategies that bundle contracts, and met with procurement officials to express concerns over these contracting strategies and how they may interfere with objectives to expand procurement opportunities for small businesses. Legislatively, the Committee

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<sup>1</sup> 15 U.S.C. § 632(o)(2); 15 U.S.C. § 657q(a)(2). In the 112<sup>th</sup> Congress, H.R. 4081 attempted to reconcile these provisions and improve the definition of bundling.

<sup>2</sup> 15 U.S.C. § 632(o)(2).

has been pursuing common sense reforms on bundling and consolidation. During the 112th Congress, the Committee successfully reported H.R. 4081, the Contractor Opportunity Protection Act of 2012 (COP Act), which would have improved the definition of bundling, combined the provisions on consolidation and bundling into one streamlined process, and created greater accountability for bundled contracts.<sup>3</sup> During the 113th Congress, this Committee reported favorably on H.R. 4094, the Contracting Data and Bundling Accountability Act of 2014, which sought to improve the quality of data reported on bundled and consolidated contracts in order to ensure that bundling and consolidation were justified, mitigated and tracked.<sup>4</sup> However, additional action may be required to ensure that contract bundling and justification do not irreparably damage the industrial base. This memorandum will provide an overview of bundling and consolidation, and then discuss five problems with its application. First, it will consider the problem of data quality. Next, it will examine the problem of the timeliness of the publication of a justification. Third, it will examine the problem of the SBA's review process. Fourth, it will consider issues regarding the FSSI. Finally, it will review the Office of Federal Procurement Policy (OFPP) initiative on category management.

**a. Process: How Bundling and Consolidation are Supposed to Operate**

In order to discuss the impediments contract bundling and consolidation create for small businesses attempting to compete for federal contracts, it is first necessary to understand the requirements bundling and consolidation impose on the contracting process, and the challenges faced by small firms as a result. When an agency or SBA identifies a contract as bundled, or the agency determines that it is consolidated, additional analysis is required. If the contract is bundled and exceeds the substantial bundling threshold, which is currently \$8 million for the Department of Defense (DoD); \$6 million for the National Aeronautics and Space Administration (NASA), the General Services Administration (GSA), and the Department of Energy (DOE); or \$2.5 million for any other agency, the contracting agency is required to provide the SBA's Procurement Center Representative (PCR) and the agency's own Office of Small and Disadvantaged Business Utilization (OSDBU) with a statement explaining why the underlying requirements cannot be met without bundling the contract, and "why the agency has determined that the bundled contract [is] necessary and justified."<sup>5</sup> This criteria may include: (1) measurable cost savings; (2) quality improvements; (3) reduction in acquisition cycle times; (4) better terms and conditions; or (5) other benefits.<sup>6</sup> However, achieving reductions in "administrative or personnel costs alone shall not be a justification for bundling of contract requirements unless the cost savings are expected to be substantial in relation to the dollar value of the procurement requirements to be consolidated."<sup>7</sup>

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<sup>3</sup> A version of H.R. 4081 passed the House as section of H.R. 4310, the National Defense Authorization Act for Fiscal Year 2013 (NDAA). However, most of the bundling provisions were dropped in conference before the NDAA was signed into law as Pub. L. No. 112-239.

<sup>4</sup> A version of H.R. 4094 became law as § 822 of Pub. L. No. 113-646 (2014).

<sup>5</sup> 48 C.F.R. § 7.105; 15 U.S.C. § 644(a). A PCR is a SBA employee charged with overseeing another agency's procurement process to ensure adherence to the Act.

<sup>6</sup> 15 U.S.C. § 644(e). Measurable cost savings has been regulatorily defined as "(A) Benefits equivalent to 10 percent of the contract or order value (including options), where the contract or order value is \$94 million or less; or (B) Benefits equivalent to 5 percent of the contract or order value (including options) or \$9.4 million, whichever is greater, where the contract or order value exceeds \$94 million;" however, administrative or personnel savings must exceed 10 percent of the value of the contract. SBA, Final Rule: Acquisition Process: Task and Delivery Order Contracts, Bundling, Consolidation, 78 Fed. Reg. 61,114, 61,139 (Oct. 2, 2013).

<sup>7</sup> 15 U.S.C. § 644(e).

If an agency has determined that it needs to bundle a contract, the head of the contracting activity (HCA)<sup>8</sup> is responsible for identifying the specific benefits, assessing the impediments the procurement strategy poses to small business participation as a prime contractor, identifying ways to mitigate these impediments, and making a determination that “the anticipated benefits of the proposed bundled contract justify its use.”<sup>9</sup> If the PCR determines that a contract was bundled but not identified as such, or objects to a justification or mitigation strategy, the PCR can delay the procurement while SBA and the agency negotiate, although the agency ultimately will make the decision regarding the award.<sup>10</sup>

The process of consolidating contracts involves its own process and set of criteria. Before an agency can issue a consolidated contract for more than \$2 million, the Chief Acquisition Officer (CAO) or Senior Procurement Executive (SPE) must certify that the agency has conducted market research; identified “alternative contracting approaches that would involve a lesser degree of consolidation of contract requirements;” determined, in writing, that the consolidation is “necessary and justified;” identified any negative effects on small businesses due to the acquisition strategy; and ensured “that steps will be taken to include small business concerns in the acquisition strategy.”<sup>11</sup> In contrast to the bundling requirements, this requires that a more senior agency official make the certification, and applies to contracts above \$2 million – smaller contracts than those covered by bundling rules.<sup>12</sup> However, the agency is not required to provide this document to SBA, but must coordinate it with their OSDDBU.<sup>13</sup>

Further, under contract consolidation, the justification requirements are different. The determination made by the CAO or SPE can find that the consolidation is “necessary and justified” if the “benefits of the acquisition strategy substantially exceed the benefits of each of the possible alternative contracting approaches.”<sup>14</sup> The benefits to be considered are quality, acquisition cycle, terms and conditions, or any other benefit. However, the benefits of consolidation, unlike those of bundling, need not be “quantifiable in dollar amounts.”<sup>15</sup> Thus, it is much more difficult to assess the value of anticipated benefits of consolidation versus bundling. Perhaps this explains why the Committee is unaware of any PCR challenges to consolidation actions, despite explicit statutory authorization for the PCRs to pursue this course of action.<sup>16</sup>

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<sup>8</sup> The HCA is usually the head of a regional office, so an agency will have multiple HCAs.

<sup>9</sup> *Id.* at § 644(e)(3).

<sup>10</sup> *Id.* at § 644(a).

<sup>11</sup> 15 U.S.C. § 657q(c)(1).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at § 644(k).

<sup>14</sup> *Id.* at § 657q(c)(2).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at § 644(l).

## **b. The Problem of Data**

Since the passage of the original bundling provisions in 1997, there have been reporting requirements associated with contract bundling, but they have been largely ignored. The Small Business Jobs Act of 2010 (Jobs Act) built up these reporting requirements, but it is only new regulations that are adding prospective notification requirements.<sup>17</sup> For the past 16 years, SBA has been required to develop and maintain a database tracking the bundling of contracts. Specifically, the database was to record each contract bundled and each small business displaced due to contract bundling.<sup>18</sup> Unfortunately, SBA has never collected the information on displaced businesses, and, as will be discussed later, the database of bundled contracts relies on self reporting by agencies to the detriment of data quality. Additionally, SBA was to use this information to track whether an agency complied with its mitigation plan and to revisit each bundled contract being considered for a recompetes, in order to see whether the bundled contract achieved the benefits included in the initial bundling justification.<sup>19</sup> All of this information was to be included in an annual report to Congress—a report that has not been submitted in over two years. Further, the underlying analysis that was to be included in the report has never been completed, although new SBA regulations anticipate beginning to collect the data necessary for such an analysis.<sup>20</sup>

To understand the problems associated with bundling and consolidation, it is necessary to know how prevalent these practices are within the procurement system. While SBA's attempt to begin collecting data is welcome, given that SBA has only 50 PCRs to review bundling and consolidation, this is unlikely to solve the data problem. The problems with the data on bundled and consolidated contracts are well documented.<sup>21</sup> While the legislative actions of the last Congress required SBA, GSA and DoD to prepare a plan to improve the quality of this data, the final law did not include the requirement that this plan ever be implemented, or that the Government Accountability Office (GAO) assess the effectiveness of the plan.<sup>22</sup> Without these latter two steps, the data quality improvement plan risks becoming simply a paperwork exercise, rather than a means of improving the identification, justification and mitigation of bundled and consolidated contracts. Therefore, the Subcommittee seeks testimony on whether additional legislation is needed to fully implement these reforms.

## **c. The Problem of Timing**

Under the Jobs Act, the Federal Acquisition Regulatory Council (FAR Council) was to issue regulations requiring that all bundling justifications be published on the agency website annually.<sup>23</sup> While this rule has not been published after nearly five years, SBA did publish a companion rule

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<sup>17</sup> Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 1312, 124 STAT. 2504, 2537 (2010).

<sup>18</sup> 15 U.S.C. § 644(p).

<sup>19</sup> *Id.*

<sup>20</sup> 78 Fed. Reg. at 61,140.

<sup>21</sup> See, *Bungling Bundling* Hearing before the H. Comm. on Small Business, Subcomm. on Contracting and Workforce Hearing, 113-041 (2013); GAO, SMALL BUSINESS CONTRACTING: UPDATED GUIDANCE NEEDED FOR REPORTING OF CONSOLIDATED CONTRACTS, GAO-14-36 (2013).

<sup>22</sup> § 822 of Pub. L. No. 113-646 (2014).

<sup>23</sup> 15 U.S.C. § 644(q).

on October 2, 2013.<sup>24</sup> Further, as part of the same regulation, SBA embraced an idea supported by the Committee as part of the COP Act. Specifically, if an acquisition strategy proposes bundling a procurement currently performed by a small business, the agency will be required to notify that business “at least 30 days prior to the issuance of the solicitation for the bundled or substantially bundled requirement” and provide the PCR’s contact information to the business.<sup>25</sup> The COP Act went further, requiring notification of the businesses that had submitted offers on the prior contract, but this is a prospective action that gives some small businesses advanced notice of threats to their contracts.

Another approach was suggested by Subcommittee Ranking Member Meng during the last Congress. Specifically, she proposed an amendment to H.R. 4435, the National Defense Authorization Act for FY 2015, which would have required that the bundling justification itself be published prior to the issuance of a solicitation. While this amendment passed the House, it was not included in the final law. Given that unjustified bundling and consolidation may only be challenged at GAO on a pre-award basis and the challenge must explain why the justification is flawed, this would have allowed small businesses to raise better challenges to bundling and consolidation.<sup>26</sup> Simply requiring that justifications be published annually does not provide this benefit. Therefore, the Subcommittee will receive testimony on whether justifications need to be published prior to or concurrent with the solicitation.

#### **d. The Problem of PCR Review**

As previously explained, SBA’s PCRs provide an important check on bundling and consolidation. However, SBA’s own rules may have inadvertently limited the ability of PCRs to address bundling and consolidation. Specifically, SBA regulations read:

PCRs will review all acquisitions that are not set-aside or reserved for small businesses above or below the Simplified Acquisition Threshold, to determine whether a set-aside or sole source award to a small business under one of SBA’s programs is appropriate and to identify alternative strategies to maximize the participation of small businesses in the procurement. This review includes acquisitions that are Multiple Award Contracts where the agency has not set-aside all or part of the acquisition or reserved the acquisition for small businesses. It also includes acquisitions where the agency has not set-aside orders placed against Multiple Award Contracts for small business concerns.

13 C.F.R. § 125.2(b)(1)(i)(A).

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<sup>24</sup> SBA, *Final Rule: Acquisition Process: Task and Delivery Order Contracts, Bundling, Consolidation* 78 Fed. Reg. 61,113 (2013).

<sup>25</sup> 78 Fed. Reg. at 61,139; *see* 48 C.F.R. 10.001(c)(2).

<sup>26</sup> A protest based on alleged improprieties in a solicitation that are apparent prior to the closing time for receipt of initial proposals must be filed before that time. 4 C.F.R. § 21.2(a)(1). *See also*, *CYIOS, Inc.* 2012 CPD ¶ 205, B-402728.3 (2012) (Challenges to bundling or consolidation must specifically challenge the agency’s calculation of cost savings or otherwise discuss the substantial benefits the agency maintains it will obtain).

At first, this rule seems a prudent way to manage SBA's resources. With only 50 PCRs, SBA cannot possibly review all procurements, so a decision to not review contracts that are set aside for small businesses seems reasonable. However, this choice has unintended consequences. Contracts that should have been completely set aside for small business are no longer reviewed when one award is reserved for small businesses. There is no guarantee that this reserved award will result in a single task order for the small business. Indeed, a contracting officer previously explained to Committee staff in 2012 that if he reserved a seat on a contract for a small business, that the contract would not be considered bundled even if the small business received no awards.<sup>27</sup> Thus, SBA's own contracting regulations may be contributing to unjustified consolidation by ensuring that SBA will not review certain consolidated contracts. In turn, this leads to problems arising from a specific type of consolidation: the Federal Strategic Sourcing Initiative (FSSI).

e. **The Problem of FSSI**

At the most basic level, strategic sourcing is an effort by the government to understand how it buys what it buys. Ideally, it does so that it can better structure procurements in a manner that allows for productive, cost-effective relationships with its vendors.<sup>28</sup> GSA claims on StrategicSourcing.gov that "[s]trategic sourcing is NOT: [l]everaged buying, [b]undling, [c]ompetitive Sourcing, [c]onsolidated buying only, or [p]rice over value."<sup>29</sup> However, on other websites, GSA states that "[s]trategic sourcing leverages the purchasing power of the entire federal government, reducing costs of goods and services."<sup>30</sup> This leveraging of buying power normally leads to the exclusion of some contractors in order to provide enough demand to the remaining vendors, and thereby command a discount.

Like any other method of procurement, strategic sourcing is neither inherently good nor bad for small businesses; instead, it is the application of strategic sourcing that is crucial. Often, small businesses allege that strategic sourcing is synonymous with contract bundling; however, almost all of the FSSI initiatives to date have reserved awards for small business which technically makes these contracts consolidated rather than bundled, as consolidation does not require a finding that a contract will not be suitable for award to small business. As previously discussed, for any consolidated contract, such as a strategic sourcing vehicle, agencies must provide a written

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<sup>27</sup> Please see the Committee memorandum, "Bungling Bundling: How Contract Bundling and Consolidation Remain Challenges to Small Business Success" (2013), available at [http://smallbusiness.house.gov/uploadedfiles/10-10-2013\\_hearing\\_memo.doc.pdf](http://smallbusiness.house.gov/uploadedfiles/10-10-2013_hearing_memo.doc.pdf) (last accessed February 26, 2015).

<sup>28</sup> According to StrategicSourcing.gov, strategic sourcing is intended to: "[a]llow government to develop deep insight into markets and life cycle cost drivers; [c]apture and consistently develops best practice Federal requirements; [i]mplement best practices around demand management; [s]trategically manage inclusion of targeted socio-economic firms; and [c]arefully manage commodity contract portfolios to consistently deliver and improve upon negotiated best values throughout the contract administration phase." <https://strategicsourcing.gov/faq> (last accessed February 25, 2015).

<sup>29</sup> *Id.*

<sup>30</sup> <http://www.gsa.gov/portal/content/195439> (last accessed February 26, 2015). A more complete description of strategic sourcing may be found in the Committee memorandum, "Putting the Strategy in Sourcing: Challenges and Opportunities for Small Business Contractors" (2013), available at [http://smallbusiness.house.gov/uploadedfiles/6\\_13\\_2013\\_hearing\\_memo.pdf](http://smallbusiness.house.gov/uploadedfiles/6_13_2013_hearing_memo.pdf) (last accessed February 26, 2015). GAO continues to define strategic sourcing as the leveraging of purchasing power. GAO, STRATEGIC SOURCING: SELECTED AGENCIES SHOULD DEVELOP PERFORMANCE MEASURES ON INCLUSION OF SMALL BUSINESSES AND OMB SHOULD IMPROVE MONITORING 5 GAO-14-126 (2014).

justification that the consolidation is necessary and that they have considered market research, alternative contracting approaches that would involve less consolidation, and considered the negative effect of the acquisition on small businesses.<sup>31</sup> Despite requests from the Committee, neither bundling nor consolidation justifications have been provided for any of the FSSI contract vehicles to date.

However, agencies can point to savings to recommend FSSI. For example, the Administration reports that 69 agencies saved nearly \$26 million on domestic delivery services through the second quarter of FY 2014.<sup>32</sup> In FY 2011, GAO found that the four agencies responsible for 80 percent of the procurement spending managed 5 percent, or \$25.8 billion through strategic sourcing contracts that resulted in \$1.8 billion in savings.<sup>33</sup> While these savings might be sufficient to justify consolidation, they do not account for the requirement to mitigate the effects of the consolidation.

Since 2012 the popularity of strategic sourcing has only increased as a result of additional Executive Branch initiatives. This push towards strategic sourcing has benefitted a few small businesses, but harmed small businesses as a whole. First, in 2012, the Office of Management and Budget (OMB) directed agencies' Chief Information Officers to compete the transition of two information technology commodities to a strategically sourced or consolidated contract by December 31, 2012.<sup>34</sup>

In December of 2012, OMB issued a broader memorandum on strategic sourcing, creating the Interagency Strategic Sourcing Leadership Council (SSLC) and directing the SSLC to "identify at least five products and/or services for which new government-wide acquisition vehicles or management approaches should be developed and made mandatory, to the maximum extent practicable, for the SSLC agencies" for FY 2013 and FY 2014.<sup>35</sup> The OMB December 2012 memorandum pays lip service to small business, stating that "because small businesses play a vital role in Federal contracting, the SSLC includes a representative from the [SBA]."<sup>36</sup> However, when SBA disagrees with an FSSI initiative at the SSLC, it does not alter the decision to proceed.<sup>37</sup> Additionally, the December 2012 memorandum structures future FSSI initiatives in a way that will force most small businesses out of the federal marketplace, because the

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<sup>31</sup> *Id.* at § 657q(c).

<sup>32</sup> <https://strategicsourcing.gov/> (last accessed February 23, 2015). This contract awarded all of the federal government's domestic delivery services to one company.

<sup>33</sup> GAO, STRATEGIC SOURCING: IMPROVED AND EXPANDED USE COULD SAVE BILLIONS IN ANNUAL PROCUREMENT COSTS 7 (2012) (GAO-12-919) [hereinafter 2012 STRATEGIC SOURCING]. The four agencies are: the Department of Defense (DoD), Department of Homeland Security (DHS), Department of Energy (Energy), and Department of Veterans Affairs (VA).

<sup>34</sup> OMB, IMPLEMENTING PORTFOLIOSTAT (Mar. 30, 2012), available at <http://www.whitehouse.gov/sites/default/files/omb/memoranda/2012/m-12-10.pdf> (last accessed February 26, 2015). The SSLC is composed of DoD, GSA, Energy, Health and Human Services, DHS, VA, and the National Aeronautics and Space Administration, and a representative from SBA.

<sup>35</sup> OMB, IMPROVING ACQUISITION THROUGH STRATEGIC SOURCING (Dec. 5, 2012), available at [http://www.whitehouse.gov/sites/default/files/omb/memoranda/2013/m-13-02\\_0.pdf](http://www.whitehouse.gov/sites/default/files/omb/memoranda/2013/m-13-02_0.pdf) (last accessed February 26, 2015). The SSLC is composed of DoD, GSA, Energy, Health and Human Services, DHS, VA, and the National Aeronautics and Space Administration, and a representative from SBA.

<sup>36</sup> *Id.* at 2, 4.

<sup>37</sup> Comments from SBA representatives at a strategic sourcing discussion hosted by the Committee in July 2014.

memorandum moves towards mandatory use of FSSI vehicles, and looks to include more services in FSSI.<sup>38</sup>

A recent GAO study illustrates why the OMB directive is problematic. GAO explored the use of strategic sourcing by leading commercial companies, and concluded that two factors were key to predicting the success of strategic sourcing: the number of suppliers and the complexity of the goods or services being purchased.<sup>39</sup> Commercial companies found that commodities with a large number of suppliers are best for strategic sourcing since the ability to conduct vigorous competitions is fundamental to sustainable savings, and that in areas where there are few suppliers it is better to focus on only covering half of the requirements through strategic sourcing.<sup>40</sup> Second, GAO found that while industry was moving to strategically source services, the more specialized the service the more difficult the task became since “complexity drives cost.”<sup>41</sup> When these two lessons are applied to small business contracting, the challenges become more apparent.

As with all government contracts, strategic sourcing results in winners and losers. This is a risk fully understood by all small businesses, so traditionally this Committee has not inquired into specific winners and losers on any contract as long as small businesses overall prospered. However, in the case of strategic sourcing, while small businesses may be doing better as a category, losing firms claim they risk exclusion from the market. Given that the eight agencies for which OMB wants FSSI to be mandatory account for 89 percent of federal contract spending, and 81 percent of federal spending with small businesses, fears of exclusion from the federal marketplace become very real. Further, given that maintaining the ability to contract with the federal government itself requires time and resources, it is questionable whether any firm not selected as a winner on a FSSI vehicle will be able to maintain the systems necessary to compete for federal contracts years after the initial FSSI awards if there is no intervening federal work. The lack of small businesses will reduce competition for future federal contracts, and basic economic theory states that a lack of competition will result in higher prices.

This problem is exacerbated by applying FSSI to services suitable for award to small businesses. First, services are much more difficult to commoditize than goods. Second, issues of scale arise: unlike the resale of commodities, many services require a regional, if not worksite, presence which excludes many small businesses. Further, small business service providers are rarely generalists competing with the largest businesses; instead they specialize in areas where complex approaches are required. When these services are themselves commoditized, the specialized providers are rarely well situated to competitively offer the basic requirements. Finally, the operation of SBA’s size standards will pose a challenge. While most commodity size standards are employee-based, often allowing a firm to remain small despite winning a FSSI award, the size standards for services are receipts-based. Thus, a small business winning a FSSI award for services is certain to no longer be small at the time of the re-compete. If no other small firms are still contracting with the government, the question becomes where the government will turn to find small business

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<sup>38</sup> OMB, IMPROVING ACQUISITION THROUGH STRATEGIC SOURCING at 2-4.

<sup>39</sup> GAO, STRATEGIC SOURCING: LEADING COMMERCIAL PRACTICES CAN HELP FEDERAL AGENCIES INCREASE SAVINGS WHEN ACQUIRING SERVICES (2013) (GAO-13-417) [hereinafter COMMERCIAL PRACTICES].

<sup>40</sup> *Id.* at 19, 23.

<sup>41</sup> *Id.* at 17.

competitors. Thus, the decisions the federal government makes in the name of strategic sourcing will ultimately affect the health of the industrial base.

The challenges FSSI poses to small businesses and the industrial base can best be explained by analyzing several recent and pending procurements. These will now be briefly discussed.

### **i. JanSan**

As part of its Janitorial-Sanitation Supply FSSI (JanSan), GSA awarded eighteen blanket purchase agreements (BPAs), including fifteen BPAs to small businesses.<sup>42</sup> These eighteen vendors will be mandatory sources for janitorial and sanitation supply items, and GSA claims that the discounted prices on the BPA are 15.9 percent lower than standard government pricing.<sup>43</sup> In prior years, the federal government spent approximately \$600 million on products and services that will be available using this contract.<sup>44</sup>

While nearly 16 percent in savings is impressive, the question remains what the effect of this action will be on small businesses. Previously, 609 companies, including 540 small businesses, were able to compete for this work. This means that 591 companies, including 525 small businesses, will no longer be allowed to compete for federal contracts.<sup>45</sup> Less than 3 percent of companies previously active in the federal market are now active. This means that hundreds of employers will no longer need employees to work in the federal space, and that many of the companies will go out of business.

Further, the savings themselves may be suspect. Given the anticipated size of the market—\$600 million—and the anticipated price reduction—15.9 percent, simple math indicates that this contract should save the federal government nearly \$80 million annually. However, GSA is currently estimating that it will only result in “\$8 million saved in the first year, rising to \$20 million a year with increased use.”<sup>46</sup> Therefore, the federal government is only realizing at most a three percent reduction in prices.<sup>47</sup> Given that a contracting officer may compete task orders against a GSA Multiple Award Schedule contract (Schedule) and thereby obtain a discount against the base price, it raises the question of whether the federal government could have saved an equal or larger sum by simply encouraging competition at the task order level without displacing over 97 percent of the potential competitors.<sup>48</sup> These companies will likely disappear from the industrial base.

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<sup>42</sup> <http://www.gsa.gov/portal/content/206651> (last accessed February 26, 2015).

<sup>43</sup> [www.gsa.gov/fssijansan](http://www.gsa.gov/fssijansan) (last accessed February 26, 2015).

<sup>44</sup> *Id.*

<sup>45</sup> Data on number of vendors taken from GSA E-Library, available at <http://www.gsaelibrary.gsa.gov> (last accessed February 26, 2015).

<sup>46</sup> [www.gsa.gov/fssijansan](http://www.gsa.gov/fssijansan).

<sup>47</sup> A savings of \$20 million on \$600 million is a savings of about 3.33 percent. A savings of \$8 million on \$600 million is 1.3 percent.

<sup>48</sup> GSA’s Federal Acquisition Service (FAS) establishing contracting vehicles that other federal agencies may use to purchase goods and services, the well known of these vehicles are the Schedules. The Schedules account for approximately 10% of all federal contract dollars, which presently translates to about \$50 billion per year. GSA, FOR VENDORS – GETTING ON SCHEDULE, available at <http://www.gsa.gov/portal/category/100635>. Currently, there are approximately 19,000 vendors holding MAS contracts, 80 percent of which are small businesses, and they receive approximately 35 percent of the value of all MAS sales. The Schedules are broken up into 31 broad categories of

## ii. MRO

Likewise, GSA recently awarded eleven BPAs under its Maintenance, Repair and Operations (MRO) FSSI initiative.<sup>49</sup> This displaced the previous 514 contractors, including 418 small businesses and 39 service-disabled veteran-owned small businesses (SDVOSBs).<sup>50</sup> The estimated value of the eleven contracts, of which ten were awarded to small businesses, is \$1.6 billion.<sup>51</sup> GSA projects 12 percent savings, but does not provide an estimated dollar value of the savings.<sup>52</sup> No thought was given to the long term effects of displacing 98 percent of the vendors. As with the JanSan procurement, two questions remain: (1) is it possible that GSA could obtain comparable savings by competing task orders between the 514 prior contractors; and (2) will GSA be able to attract enough new companies to compete for any successor contract in order to maintain the level of savings? Further, during an industry day conferences for the JanSan and MRO procurements, businesses expressed concern that by only considering the lowest prices GSA was ignoring the total cost of ownership.<sup>53</sup> Specifically, the businesses stated that some products cost more, but were more efficient or offered substantial benefits not available with a cheaper product, so that by awarding BPAs only to the vendors promising the lowest prices, the government may end up paying more in the long run. Simultaneously, the federal government risks harming its industrial base, as most of these businesses will not be available to provide meaningful competition at the task order level and at the time of recompute.

## iii. OASIS and OASIS SB

Touted by OFPP and GSA as part of their strategic sourcing initiative, in 2014 GSA awarded two new multiple award contracts for professional services, called OASIS and OASIS SB.<sup>54</sup> The two contracts are intended to provide integrated, multidisciplinary professional services and ancillary services. Each contract provides six different types of professional services: program management, management consulting, scientific, engineering, logistics, and financial management services. OASIS was open to all offerors and has 76 awardees, whereas OASIS SB is set aside for small businesses and has 127 awardees.<sup>55</sup> The anticipated value of the two contracts is \$10 billion.

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goods and services, each of which is known as a Schedule. While a vast oversimplification, it is perhaps easiest to compare this to Amazon website, where Amazon will present multiple resellers of the same product, often at different price points. All Schedules are Indefinite Delivery, Indefinite Quantity contracts, so the contracts serve as frameworks, including all necessary clauses and the maximum price negotiated between the vendor and GSA. Awardees are not guaranteed any set amount of sales during the five year base period of the contract, but instead, each is simply guaranteed a minimum sale of \$2,500 over those five years, or during any of the three successive five year option periods, and the right to compete for task orders.

<sup>49</sup> <http://www.gsa.gov/portal/content/187135> (last accessed February 26, 2015).

<sup>50</sup> Data on number of vendors taken from GSA E-Library, available at <http://www.gsaelibrary.gsa.gov> (last accessed February 26, 2015).

<sup>51</sup> *Id.* The draft RFP states that this vehicle will be worth only \$23.6 million annually, but in response to a question from the Committee staff, GSA provided the higher number.

<sup>52</sup> <https://strategicsourcing.gov/>.

<sup>53</sup> Transcript, GSA JANSAN/MRO INDUSTRY DAY (May 15, 2013) (on file with the Committee).

<sup>54</sup> Unless otherwise indicated, information regarding OASIS and OASIS SB is from the requests for proposal, available at

[https://www.fbo.gov/index?s=opportunity&mode=form&id=b3deafdbc36ac6c2065df806fb3f646b&tab=core&\\_cview=1](https://www.fbo.gov/index?s=opportunity&mode=form&id=b3deafdbc36ac6c2065df806fb3f646b&tab=core&_cview=1) (last accessed February 26, 2015).

<sup>55</sup> <http://gsa.gov/portal/content/206191>.

The strategic sourcing element of OASIS and OASIS SB relates to the way it categorizes labor. Specifically, each vehicle has divided all labor into just over 100 categories, further subdivided into junior, journeyman, and senior levels of expertise. In doing so, GSA hopes that it will gather better data on the market rates for these services, plot them, and have a bell curve of pricing. The expectation is that over time, the bell curve will contract towards the center.<sup>56</sup> When pressed to explain why this wouldn't unduly constrain the various types of employees a contractor could utilize, the OASIS program manager stated that "[a] civilian engineer is a civilian engineer," although there are differences in rates due to factors, such as experience and expertise.<sup>57</sup> However, since small businesses often find their niche by offering highly specialized solutions, this approach may not accommodate them. Further, since the prices are intended to move towards the center, the approach does not seem to focus on obtaining the lowest price.<sup>58</sup>

Small businesses are unhappy with the award factors, which require that awards will be made to firms with the highest technical response that have fair and reasonable prices. However, the technical evaluations have little to do with the qualifications of the firms to perform specific tasks, and more to do with the firm's accounting systems, certifications, clearances, and the size of work previously performed as a prime contractor. Thus, work that small businesses are currently performing through GSA's own Schedules, or as subcontractors on complex contracts, may not be highly rated since the firms lack the appropriate accounting system or prime contract experience. This leads to a scenario where the government may be paying more for features it does not need. Indeed, there are 3,608 vendors on the four Schedules duplicated by OASIS and OASIS SB, including 2,385 small businesses.<sup>59</sup> Those vendors are not allowed to compete on the estimated \$10 billion in work expected to flow through the two new contracts.

Further, given the labor categories included in the contract, small businesses whose labor rates exceed those of the successful offerors are not eligible to participate as subcontractors. While labor rates are an important factor to consider when hiring a contractor, it is often the skill of the contractor that determines how many labor hours are required to complete a task, and what approach will be taken to that task. Thus, in this case, a winning company might have bid \$100 per hour for a computer programmer. However, a small business with expertise in designing programs to combat cyber challenges may charge more than \$100 per hour. When the government requires cyber security work, is it better served by paying the generalist \$100 per hour for 40 hours of work, or is it better served by paying the specialist \$150 per hour for 25 hours of work? From a

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<sup>56</sup> Matthew Weigelt, *OASIS Creates Thirst for Answers*, FEDERAL COMPUTER WEEK (Feb. 13, 2013), available at <http://fcw.com/articles/2013/02/13/oasis-thirst-for-answers.aspx> (last accessed February 26, 2015).

<sup>57</sup> *Id.*

<sup>58</sup> Small businesses complained that GSA did not allow new small business teams or joint ventures to compete for OASIS awards. Section 15(q)(1) of the Act requires that "[e]ach Federal agency shall include in each solicitation for any multiple award contract above [\$5.5 million] a provision soliciting bids from any responsible source, including responsible small business concerns and teams or joint ventures of small business concerns." 15 U.S.C. § 644(q)(1). While this discrepancy has been brought to GSA's attention, at a recent industry day, GSA published slides stating "[w]e have not changed our position on teaming or the creation of new Joint Ventures nor are we likely to." Email Committee staff to GSA, *Re: May 15th & SAM Q* (May 9, 2013); GSA OASIS INDUSTRY DAY SLIDE PRESENTATION 7 (May 12, 2013) (on file with the Committee). In addition to violating the clear language of the law, this also prevents more small businesses from competing on this work.

<sup>59</sup> Data on number of vendors taken from GSA E-Library for Schedules 871, 874, 874v, and 899, available at <http://www.gsaelibrary.gsa.gov> (last accessed February 24, 2015).

price perspective, the latter option saves taxpayers money, even if it costs more per hour. Furthermore, since the cyber security specialist has expertise, the product delivered may do a better job of meeting the government's needs. However, since a prime contractor may not charge a higher labor hour rate for its subcontractors than it charges for its own employees, the federal government cannot reach these experts. This harms small businesses and the industrial base, since it puts a premium on generalists rather than experts.

#### **iv. Performance Management/Continuous Process Improvement (PM/CPI)**

In 2013, GSA awarded fifteen BPAs against its Mission Oriented Business Integrated Services (MOBIS) Schedule as part of FSSI. MOBIS currently has 1,938 contractors, of whom 1,271 are small businesses.<sup>60</sup> In 2014, about \$3.9 billion in task orders were placed against MOBIS.<sup>61</sup> The BPA holders received about \$1.3 billion of those funds—approximately one-third of all dollars spent using MOBIS. This means that 1,923 businesses, including 1,270 small businesses, were not allowed to compete on task orders for strategic planning, performance management, business analysis, process improvement, communications, change management, training and certification. In exchange for excluding small businesses from areas where they were traditionally competitive, GSA negotiated discounts averaging 5.5 percent off of the basic contract rate, although some vendors offered discounts as low as two percent. Ironically, GSA boasts that the contract provides an “[a]cceleration of business transformation by creating an innovative culture of continuous, measurable improvement that eliminates low value add activities and . . . [provides a c]hoice of wide variety of contractors.”<sup>62</sup> Instead, there is less competition for work, to the detriment of small businesses and the industrial base.

#### **v. Office Supply 3 (OS3)**

OS3 is GSA's third attempt at an office supply FSSI. Under the prior vehicle, OSII, GSA reported nearly \$77 million in total savings and a 9 percent increase in dollars awarded to small businesses.<sup>63</sup> To accomplish this, GSA issued BPAs against its existing Office Supply Schedule. At the time of the RFP, there were 527 potential vendors, of which over 90 percent were small businesses and 260 were active.<sup>64</sup> Of these, 48 submitted offers, and 13 small businesses won BPAs, raising questions about the fate of over 200 remaining active vendors.<sup>65</sup> As of May 2013, GSA reported that 70 percent of office supply sales were being made to Schedule vendors that do not hold a FSSI BPA, with the remaining 30 percent of task orders awarded through OSII.<sup>66</sup> Additionally, the majority of the savings under OSII were attributed to price reductions by firms

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<sup>60</sup> Data on number of vendors taken from GSA E-Library, available at <http://www.gsaelibrary.gsa.gov> (last accessed February 24, 2015).

<sup>61</sup> Current value of MOBIS pulled from the Schedule Sales Query Report Generation System (SSQ) on February 24, 2015, available at [www.ssq.gsa.gov](http://www.ssq.gsa.gov).

<sup>62</sup> <http://www.gsa.gov/portal/content/172831>.

<sup>63</sup> May 23, 2013 GSA Briefing to Committee Staff [hereinafter May 23 Briefing].

<sup>64</sup> FSSI, GSA, SSWG BRIEFING ON OFFICE SUPPLIES 1 (2012) [hereinafter SSWG BRIEFING]; Email from Saul Japson, Senior Advisor for Congressional Affairs, GSA, to Committee Staff (May 22, 2012) (on file with recipient).

<sup>65</sup> Approximately 170 small businesses benefit from the awarded BPAs by acting as a consortium with those BPA awarded small businesses.

<sup>66</sup> May 23 Briefing.

that did not have OSII BPAs. Those firms without OSII BPAs complained that the volume of businesses they received post OSII drastically declined, especially since some agencies mandated use of the OSII BPAs. Ultimately, nineteen agencies used the OSII BPAs, generating \$319 million in sales as of March 2012.<sup>67</sup> These 13 BPA holders ultimately received more orders than all of the small businesses combined prior to OSII.<sup>68</sup>

OS3, the successor to OSII, abandoned the Schedules completely and was launched in 2014 as a standalone mandatory contract with 23 awards to small businesses, and one award to a large business.<sup>69</sup> However, the remaining 503 GSA Schedule holders will not be allowed to compete for any work. OS3 does not anticipate any additional savings in the areas previously covered by OSII.<sup>70</sup> Instead, the additional savings will result from a new category geared towards overseas purchases. Only the large business will be allowed to fulfill that work.<sup>71</sup> Therefore, the government has displaced over 400 small businesses to no real purpose. Obviously, this raises issues about the fate of those companies not successful in the OS3 competition, and the health of the industrial base when an OS4 becomes necessary.

#### **vi. Future Vehicles**

While little documentation has been provided, in public speaking events OFPP and GSA have discussed additional potential FSSI initiatives. Among these are the service components for the JanSan and MRO contracts. Specifically, in January the OFPP Administrator suggested strategically sourcing janitorial services, as opposed to the supplies covered by JanSan.<sup>72</sup> Likewise, GSA has discussed a building maintenance and operations services contract, as opposed to the MRO vehicle.<sup>73</sup> Because of the physical presence required by these services, these could pose significant challenges for small businesses. Furthermore, a request for information was issued in 2014 for a FSSI for laptops and desktops.<sup>74</sup> While each of these new initiatives poses challenges for small businesses and the industrial base, many future federal activities will not be called FSSI, but category management. It is to that new approach that this memorandum now turns.

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<sup>67</sup> SSWG BRIEFING at 7.

<sup>68</sup> SSWG BRIEFING at 7.

<sup>69</sup> <http://www.gsa.gov/portal/content/195439> (last accessed February 26, 2015).

<sup>70</sup> GSA reports that, "OS3 is expected to provide more than \$90 million in annual savings captured through lower prices." <http://www.gsa.gov/portal/content/195439> (last accessed February 26, 2015). However, in meetings with the Committee staff and in a roundtable on strategic sourcing, GSA stated that any additional savings would occur due to the inclusion of global supply and the stocking of on base stores. The majority of these savings were previously occurring under OSII.

<sup>71</sup> <http://www.gsa.gov/portal/content/195439> (last accessed February 26, 2015).

<sup>72</sup> Remarks of Joseph Jordan, *Strategic Sourcing of Professional Services*, to the Professional Services Council, TechAmerica, ACT-IAC, the Aerospace Industries Association, and the Coalition for Government Procurement (Jan. 31, 2013) (attended by Committee Staff).

<sup>73</sup> Transcript, GSA JANSAN/MRO INDUSTRY DAY (May 15, 2013) (on file with the Committee).

<sup>74</sup> <https://interact.gsa.gov/blog/important-notice-omb-fssi-laptops-and-desktops> (last accessed February 26, 2015).

## f. Category Management

On December 4, 2014, the OFPP Administrator announced her intention to use the SSLC in pursuit of a new initiative for the federal government to begin “buying as one through category management.”<sup>75</sup> Specifically, the memorandum warns that “agencies often award contracts for similar goods and services.”<sup>76</sup> When agencies award multiple contracts in a manner that does not expand the number of companies able to compete for work, OFPP is correct in asserting that they have simply created a new set of bid and proposal costs for small businesses. However, when the government insists upon limiting the number of contracts without providing a mechanism for new entrants to the market, or as a means to limit the number of companies able to compete, the risks inherent in consolidation and bundling remain.

OFPP states that category management, “can best be accomplished by managing commonly purchased goods and services—approximately half of the Federal Government’s overall spend—through common categories . . . . This approach includes strategic sourcing, but also a broader set of strategies to drive performance, like developing common standards in practices and contracts, driving greater transparency in acquisition performance, improving data analysis, and more frequently using private sector (as well as government) best practices.”<sup>77</sup> There is much to parse in this one sentence. While concerns with strategic sourcing have already been expressed, limiting the number of government unique requirements could be a benefit to small businesses that consider these barriers to entry. Likewise, increased transparency and accountability will let great performers shine through, and encourage others to adopt their approach. However, when the government relies on private sector standards for procurement, it engages in fallacious logic, since the government and the private sector have different objectives and incentives in procurement.

The private sector looks to build long term, mutually profitable relationships with its vendors. Any savings accruing as the result of these relationships are reinvested by the company or, at a minimum, increase its cash on hand. In contrast, the government must engage fairly with any company wishing to do business with it. Due to the sheer size of the government, its buying power means that choosing to commit to just a few vendors will alter the industrial base of the country. It may not engage in long term contracts, since these are seen as anticompetitive. It also buys items such as weapons systems that are not purchased by the private sector, so it must ensure that it maintains a sufficient volume of companies from which it can buy. While a private sector company can sole source a contract without consequence, we expect the government to justify any such decision. Perhaps most importantly, federal appropriations are only good for a fixed period of time and a fixed purpose, so the government cannot pre-purchase supplies, invest savings elsewhere, or save its surpluses for future needs. This is not to say that the government cannot learn from the private sector, but the government must exercise care before adopting private sector best practices.

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<sup>75</sup> OFPP, TRANSFORMING THE MARKETPLACE: SIMPLIFYING FEDERAL PROCUREMENT TO IMPROVE PERFORMANCE, DRIVE INNOVATING AND INCREASE SAVINGS 2 (Dec. 4, 2014) available at <http://www.whitehouse.gov/sites/default/files/omb/procurement/memo/simplifying-federal-procurement-to-improve-performance-drive-innovation-increase-savings.pdf> (last accessed February 26, 2015).

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

Next, the OFPP memorandum continues to state that each category of spend will have a single government executive overseeing all contract vehicles within a category. While this may at first seem efficient, it does not allow for competing visions of federal procurement. Competition inspires innovation, so having dueling approaches or thoughts on how the government will buy within a category may be wise. As seen in chart 1, on the next page, these ten categories were worth over \$277 billion in FY 2013. Even the smallest of these categories is worth several billion dollars, and the largest categories exceed \$50 billion each.

Finally, the relevant portion of the OFPP memorandum directs GSA to develop, along with the SSLC, standards for the development and execution of category management, and requiring agencies to provide the information to GSA. GSA is then required to share the information on a Common Acquisition Platform. This platform has launched, but Committee staff cannot access the platform. Thus, the extent of implementation is unknown. However, GSA has engaged in two important actions in response to this new policy.

First, GSA has announced that the Schedules are moving a horizontal pricing model. As the GSA Commissioner for the Federal Acquisition Service explained:

In the past, offerors' prices were analyzed based solely on commercial market prices. Horizontal price analysis means GSA will be moving toward a new model that analyzes prices in comparison to market prices, including Schedule prices, for the same items. We'll be looking at pricing on current contracts as well as new offerors with the pre-award automation of pricing data. In an effort to help suppliers be as competitive as possible, GSA will be sharing information with them on how their prices compare with other vendors offering the same items. Vendors can take this information into consideration in setting or adjusting prices.<sup>78</sup>

This raises itself raises several questions. First, how GSA defines market prices and the same items will be crucial in assessing the effects of the program on small businesses. For example, will all pens be considered the same item, or will refillable pens be treated differently than disposable pens? Will the comparison be made based on stock numbers, unique product identifier codes, or other information? Likewise, how will services be priced? As previously discussed, simply looking at labor hour prices for categories of works leads to false comparisons. Secondly, if prices are being compared to the market, what market is that? Is it the commercial market, which lacks the audit rights, document retention requirements, and criminal penalties found in all federal contracts, or is it the federal market for those goods and services. Next, is the market price for a quantity of one, or is it based on some sort of volume pricing? Finally, will vendors be required to invest in expensive data reporting systems, or will GSA finally modernize its systems so that the data is captured at time of award and again when task orders are placed? The wrong answers to

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<sup>78</sup> Tom Sharpe, "Collaborating with Industry and Customers to Transform the Multiple Award Schedules" (Dec. 23, 2014) available at <http://gsablogs.gsa.gov/gsablog/2014/12/15/collaborating-with-industry-and-customers-to-transform-the-multiple-award-schedules/> (last accessed February 26, 2015).

any of these questions could force numerous small businesses out of the federal market, and damage the industrial base.

Second, GSA has announced that it is combining all of its professional services Schedules into one Schedule. There are over 4,400 professional services contracts across eight GSA Schedules, with 527 firms holding multiple contracts.<sup>79</sup> Committee analysis of those companies indicates that approximately 4,000 of those companies are small businesses.<sup>80</sup> GSA asserts that the “scope of the various Schedules frequently overlap, which has caused confusion . . . [and that] service acquisitions are increasingly complex and demand a total solution that may involve several different Schedule offerings.”<sup>81</sup> Therefore, GSA proposes to consolidate these Schedules into one professional services Schedule, and states that it will migrate the existing contracts to the new Schedule, and that the performance period and terms and conditions of the existing contract would remain constant.<sup>82</sup> However, GSA also states that it will cancel any vendor with no sales at the time of the migration. This change may be sensible, but raises concerns. First, vendors are reporting to the Committee that GSA is directing offerors to the old Schedules to withdraw their offers and resubmit to the new Schedule, and that failure to withdraw an application will result in the offer being denied. Given that these offers have been pending for up to a year, and that submitting a new offer will require a significant amount of time and money, and that new offers can take up to 18 months to process, these businesses complain that they are being excluded from the federal market for several years. Second, combining these Schedules in light of the PM/CPI BPAs and OASIS contract vehicles raises questions about the volume of work available to these Schedule holders. GSA has not provided a consolidation justification.

Interestingly, neither OFPP nor GSA documents on category management suggest maintaining opportunities for small businesses, increasing their opportunities, or improving the health of the industrial base. Also absent from these discussions are the concepts of innovation or reducing barriers to entry. Finally, the documents do not suggest increasing competition. While it is too soon to judge how category management will ultimately affect small business and the industrial base, the terms of the program suggest additional consolidation and bundling.

#### **g. Bundling and Consolidation Conclusion**

Realizing that it is impossible to eradicate bundling and consolidation, the Subcommittee seeks suggestions on how to improve the current implementation of these practices. Specifically, the Subcommittee is interested in improving data quality, with an eye towards increasing justification and mitigation. Additionally, the Subcommittee wishes to know if statutory changes are necessary

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<sup>79</sup> Brad DeMers “*Improving Professional Service Schedules - Changes are Coming!*” (2014) available at <https://interact.gsa.gov/blog/improving-professional-service-schedules-changes-are-coming> (last accessed February 26, 2015). The eight schedules are the Consolidated (00CORP), MOBIS (874), PES (871), FABS (520), AIMS (541), LOGWORLD (874V), Environmental (899), and Language (738II).

<sup>80</sup> Data on number of vendors taken from GSA E-Library available at <http://www.gsaelibrary.gsa.gov> (last accessed February 25, 2015).

<sup>81</sup> Brad DeMers “*Improving Professional Service Schedules - Changes are Coming!*” (2014) available at <https://interact.gsa.gov/blog/improving-professional-service-schedules-changes-are-coming> (last accessed February 26, 2015).

<sup>82</sup> *Id.*

to address the problems of timeliness and PCR review. Finally, it seeks advice on its approach to FSSI and category management.

### **III. Goaling**

Recognizing the importance of small businesses to the economy, Congress has established a series of programs to assist small businesses competing for federal contracts.<sup>83</sup> It did so because the use of small businesses as contractors is “in the interest of maintaining or mobilizing the Nation’s full productive capacity, [. . .] in the interest of war or national defense programs, [and . . .] 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.”<sup>84</sup> To achieve these aims, the Act establishes a series of goals.

#### **a. Types of Goals**

There are three types of small business goals: numerical goals, industrial goals, and maximum practicable utilization. The most commonly recognized of these goals are the numerical goals, and of those the prime contracting goals are the most prominent. Section 15(g) of the Act requires that the federal government have a government-wide goal of awarding “not less than 23 percent of the total value of all prime contracts awards for each fiscal year” to small business concerns. Additionally, there is a goal of awarding three percent of all prime contract dollars to SDVOSBs, and three percent to qualified HUBZone small business concerns.<sup>85</sup> Further, there is a goal of awarding five percent of all prime contract dollars to small business concerns owned and controlled by socially and economically disadvantaged individuals (SDBs) and five percent to small business concerns owned and controlled by women (WOSBs).<sup>86</sup> In FY 2013, the federal government met the 23 percent goal, and exceeded the SDB and SDVOSB goals.<sup>87</sup> Initial indications are that the federal government will meet the small business prime contract goal again for FY2014.

The federal government has subcontracting goals as well as prime contracting goals. The SBA sets the subcontracting goal at 36 percent of subcontracted dollars during the fiscal year, and statute sets the goals for SDBs, HUBZones, WOSBs, and SDVOSBs at the same level as the respective prime contracting goals.<sup>88</sup> In FY 2013, the federal government met only the WOSB and

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<sup>83</sup> For information on these programs, please see Committee Memorandum, *Small Business Act Programs for Federal Contractors* (February 2013), available at [http://smallbusiness.house.gov/uploadedfiles/small\\_business\\_act\\_programs\\_for\\_small\\_federal\\_contractors.pdf](http://smallbusiness.house.gov/uploadedfiles/small_business_act_programs_for_small_federal_contractors.pdf) (last accessed February 26, 2015).

<sup>84</sup> The Act, § 15(a), 15 U.S.C. § 644(a).

<sup>85</sup> The Act, §§ 15(g)(1)(ii)-(iii), 15 U.S.C. §§ 644(g)(1)(ii)-(iii).

<sup>86</sup> The Act, §§ 15(g)(1)(iv)-(v), 15 U.S.C. §§ 644(g)(1)(iv)-(v).

<sup>87</sup> SBA, “FY 2013 Procurement Scorecard” available at

[https://www.sba.gov/sites/default/files/files/FY13\\_Government-Wide\\_SB\\_Procurement\\_Scorecard\\_Public\\_View\\_2014-04-28.pdf](https://www.sba.gov/sites/default/files/files/FY13_Government-Wide_SB_Procurement_Scorecard_Public_View_2014-04-28.pdf) (last accessed February 26, 2015).

<sup>88</sup> The Act, § 15(g)(1), 15 U.S.C. § 644(g)(1).

SDB subcontracting goals.<sup>89</sup> Subcontracting goals only apply to contracts awarded to other-than-small business concerns.<sup>90</sup>

In addition to the numerical goals, the Act includes goals based on industrial diversity. The Act realizes that simply looking at the dollars awarded to small businesses does not meet its aims. Rather, it requires that, “[i]n establishing goals . . . the head of each Federal agency shall make a consistent effort to annually expand participation by small business concerns from each industry category in procurement contracts and subcontracts of such agency, including participation by” each category of small business.<sup>91</sup> If no attention is paid to industry distribution, the numerical goals could be met simply by having all construction work performed by small businesses. While this would benefit small construction contractors, it would not meet the ultimate aims of the Act. SBA does not currently track industrial distribution, although this information is available using the Federal Procurement Data System.

Finally, the Act sets as its goals that “small business concerns [SDVOSBs, HUBZone small business concerns, SDBs and WOSBs] shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems.”<sup>92</sup> Every prime contract awarded by the federal government includes a clause restating that policy.<sup>93</sup> Each federal agency is required to have an individual goal that represents the “maximum practicable opportunity” for each category of small businesses.<sup>94</sup>

#### **b. SBA’s Role in Goaling**

SBA negotiates each agency’s goals on an annual basis.<sup>95</sup> It then reports annually on the numerical goals through its scorecard process. SBA’s scorecard awards a letter grade to the federal government and each agency. Eighty percent of the grade is based on the prime contracting achievements.<sup>96</sup> Subcontracting achievements only account for 10 percent of a grade.<sup>97</sup> The final 10 percent is based on an agency’s plan progress.<sup>98</sup>

To calculate the prime contracting portion of the scorecard, SBA looks at the agency’s achievement for each goal relative to the agency’s specific goal.<sup>99</sup> Prime contract dollars awarded to small businesses are worth sixty percent of the score, and each of the subcategory goals is worth

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<sup>89</sup> SBA, “FY 2013 Procurement Scorecard” available at [https://www.sba.gov/sites/default/files/files/FY13\\_Government-Wide\\_SB\\_Procurement\\_Scorecard\\_Public\\_View\\_2014-04-28.pdf](https://www.sba.gov/sites/default/files/files/FY13_Government-Wide_SB_Procurement_Scorecard_Public_View_2014-04-28.pdf) (last accessed February 26, 2015).

<sup>90</sup> The Act, § 8(d), 15 U.S.C. § 637(d).

<sup>91</sup> The Act, § 15(g)(2)(E), 15 U.S.C. § 644(g)(2)(E).

<sup>92</sup> The Act, § 8(d), 15 U.S.C. § 637(d).

<sup>93</sup> *Id.*

<sup>94</sup> The Act, § 15(g)(1)(B), 15 U.S.C. § 644(g)(1)(B).

<sup>95</sup> The Act, § 15(g)(1)(B), 15 U.S.C. § 644(g)(1)(B).

<sup>96</sup> SBA GRADE CALCULATION METHODOLOGY 2 (2014) available at [https://www.sba.gov/sites/default/files/files/Scorecard-Grade-Calculation-Methodology-FY13\\_FINAL\\_2014-06-04.pdf](https://www.sba.gov/sites/default/files/files/Scorecard-Grade-Calculation-Methodology-FY13_FINAL_2014-06-04.pdf) (last accessed February 26, 2015).

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 5.

10 percent.<sup>100</sup> The resulting number is worth eighty percent of the final grade. The subcontracting portion of the scorecard uses an identical methodology to obtain the final number, which is worth 10 percent of the score.<sup>101</sup>

The final 10 percent is based on seven success factors. The first factor is commitment to small business utilization, which asks whether the agency “has demonstrated, through action and documented evidence, a commitment to utilize small businesses to obtain goods and services.”<sup>102</sup> The second factor is effective engagement of senior level management in achieving small business goals, and it requires that the agency’s “senior leadership, (i.e. Deputy Secretary, Chief Acquisition Officer, Senior Procurement Executive, senior program managers, and OSDBU Director) demonstrated, through action and documented evidence, that they have clearly communicated the importance of achieving the agency’s small business contracting goals through the chain of command to the contracting officer level.”<sup>103</sup> The third factor is the data quality of small business contracting, and requires that the agency demonstrate “through action and documented evidence, a commitment to small business contracting data quality.”<sup>104</sup> The fourth factor is training of acquisition staff, and asks if the agency has “demonstrated a commitment to small business utilization through regular training of acquisitions staff on the issues/procedures/policies/regulations impacting small business.”<sup>105</sup> The fifth factor is outreach to small business, and asks if the agency has demonstrated “a commitment to growing their small business supplier base and increasing awareness of contracting opportunities for small businesses.”<sup>106</sup> The sixth factor is subcontracting, and requires that the agency demonstrate a commitment to expanding subcontracting opportunities for small businesses.<sup>107</sup> The seventh and final factor is unbundling, and asks whether the agency has a clearly communicated policy to address and mitigate the adverse effects of contract bundling on small businesses.<sup>108</sup> Each of these factors is worth one point, for a total of seven points.<sup>109</sup> This overall score is then worth 10 percent of the letter grade.<sup>110</sup>

### **c. Problems Reconciling SBA’s Scorecard and the Act’s Goals.**

Under SBA’s scorecard system, the federal government received an A for FY 2013.<sup>111</sup> In FY 2014, the federal government spent \$440 billion on contracts, of which approximately \$98 billion

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<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 6.

<sup>102</sup> *Id.* at 7.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* It is not explained how this is not duplicative of the subcontracting goals worth ten percent of the scorecard.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> SBA, “FY 2013 Procurement Scorecard” available at [https://www.sba.gov/sites/default/files/files/FY13\\_Government-Wide\\_SB\\_Procurement\\_Scorecard\\_Public\\_View\\_2014-04-28.pdf](https://www.sba.gov/sites/default/files/files/FY13_Government-Wide_SB_Procurement_Scorecard_Public_View_2014-04-28.pdf) (last accessed February 26, 2015).

was spent with small businesses.<sup>112</sup> While an A and a healthy percentage of small business prime contracting dollars would seem to indicate that a healthy percentage of dollars are being awarded to small businesses, Chart 2 shows that the use of small businesses is declining even as the percentage of dollars awarded to small businesses increases. Additionally, it is worth noting that in obtaining its A, the federal government did not meet half of its numerical goals.<sup>113</sup>

**Chart 2. Small Business Contracting FY10-FY14<sup>114</sup>**

<b>FY</b>	<b>Total Contract Dollars (in Billions)</b>	<b>Total Small Business (SB) Dollars</b>	<b>Total Number of SB Actions</b>	<b>Total DoD Contract Dollars</b>	<b>Total DoD Small Business Dollars</b>	<b>Total Number of DoD SB Actions</b>	<b>Average Value of Small Business Contract Action</b>	<b>Average Value of DoD Small Business Contract Action</b>
<b>11</b>	\$549.6	\$103.6	3,346,553	\$374.1	\$60.4	2,325,622	\$30,957.23	\$25,971.55
<b>12</b>	\$518.3	\$100.0	2,584,893	\$290.1	\$60.2	1,453,952	\$38,686.32	\$41,404.39
<b>13</b>	\$462.3	\$91.9	1,560,467	\$308.5	\$50.0	711,998	\$58,892.63	\$70,224.92
<b>14</b>	\$444.7	\$98.9	1,390,987	\$284.7	\$55.6	745,626	\$71,100.59	\$74,568.22

From FY11 through FY14, the percentage of dollars awarded to small businesses increased each year, from just over 18 percent to approximately 22.25 percent.<sup>115</sup> At the same time, despite a decline in overall federal spending, the dollars awarded to small businesses remained fairly constant during this period. While this would normally be heralded as a success, a deeper dive into the numbers shows that the number of small business contract actions fell by almost 60 percent and the average size of a contract action increased 230 percent.<sup>116</sup> This reflects that fewer small businesses are winning contracts, but those contracts are worth more, which may indicate that some small businesses are doing very well but many others are losing opportunities to compete.

Similarly, at DoD, which is arguably a better reflection of the federal government’s ability to maintain a healthy industrial base capable of supporting defense programs, the results were worse. The percentage of contract dollars awarded to small businesses at DoD increased from just over 16 percent to just over 19 percent, but the actual dollars only fluctuated by about 10 percent.<sup>117</sup> The number of small business contract actions at DoD fell by almost 70 percent, and the value of those contract actions rose by nearly 290 percent.<sup>118</sup> The number of companies registered to do business with the federal government has dropped by over 100,000 from 2012, so that only 273,072 small

<sup>112</sup> According to the Federal Procurement Data System (FPDS), available at <https://www.fpds.gov>, \$98,180,623,220.45 in contracts was awarded to small businesses, out of \$444 billion total (last accessed January 28, 2015).

<sup>113</sup> SBA, “FY 2013 Procurement Scorecard,” available at [https://www.sba.gov/sites/default/files/files/FY13\\_Government-Wide\\_SB\\_Procurement\\_Scorecard\\_Public\\_View\\_2014-04-28.pdf](https://www.sba.gov/sites/default/files/files/FY13_Government-Wide_SB_Procurement_Scorecard_Public_View_2014-04-28.pdf) (last accessed February 26, 2015).

<sup>114</sup> *Id.*

<sup>115</sup> Analysis based upon FPDS, available at <https://www.fpds.gov> (last accessed January 28, 2015). Copies of reports are on file with the Committee.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

businesses are still registered to compete for federal contracts.<sup>119</sup> This speaks to a greater problem in the industrial base—a declining participation rate.

SBA’s Office of Advocacy (Advocacy) recently highlighted this small business participation problem. Specifically, Advocacy identified 23 industries in which the government spends over \$500 million per year, but where less than 10 percent of procurements are awarded to small businesses.<sup>120</sup> These are areas important to the industrial base where small businesses are not participating, but this is not reflected in the current scorecard process.

Given that these factors all indicate that the aims of the Act are not being met, it is surprising the SBA believes the federal government merits an A. However, it is worth further exploring whether by ignoring or minimizing factors, the scorecard is actually harming small businesses. There is some indication that this is the case. For example, if an agency can receive an A without meeting its subcontracting goals as long as it meets its prime contracting goals, then the subcontracting opportunities for small businesses become less important to that agency. Indeed, senior executives at DoD are only evaluated on whether the agency met its prime contracting goals.<sup>121</sup> In some cases, this is leading to a practice called “NAICS shopping,” which will be discussed in Section IV, but which allows an agency to mislabel a contract for purposes of the size standard, and thereby inflate its prime contracting goals at the expense of its subcontracting goals. In other cases, it is making FSSI and bundling more attractive—by awarding a large contract to a small number of small businesses, an agency can meet its prime contracting goals without needing to engage multiple small businesses.

The importance of prime contract awards to small businesses cannot be overstated, yet this cannot be the sole measure of small business success. Therefore, the Subcommittee seeks testimony on how to better incentivize agencies to use small subcontractors, increase the number of small businesses with which it contracts, and to engage small businesses in industries where they are currently underrepresented.

#### **IV. Office of Hearings and Appeals**

##### **a. Introduction**

OHA is an independent office of the SBA established in 1983 to provide an independent, quasi-judicial appeal of certain SBA program decisions.<sup>122</sup> Specifically, OHA hears appeals of: size determinations; contracting officer designations of North American Industry Classification System (NAICS) codes on Federal contracts; eligibility determinations for SDVOSBs, WOSBs, Economically Disadvantaged WOSB (EDWOSB); and eligibility determinations, suspensions, and terminations for the 8(a) business development program.<sup>123</sup> OHA’s role as an independent and

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<sup>119</sup> Data retrieved from the System for Award Management available at [www.sam.gov](http://www.sam.gov) (last accessed January 28, 2015). This number is down by over 100,000 small businesses from 2012, when DSBS reported 382,092 active small businesses.

<sup>120</sup> SBA Advocacy, EVALUATION OF THE SMALL BUSINESS PROCUREMENT GOALS ESTABLISHED IN SECTION 15(G) OF THE SMALL BUSINESS ACT 41-42 (2014).

<sup>121</sup> Committee conversations with DoD OSBP.

<sup>122</sup> [www.sba.gov/oha/about-us](http://www.sba.gov/oha/about-us) (last accessed February 26, 2015).

<sup>123</sup> 13 C.F.R. § 134.102.

impartial adjudicator is therefore integral to maintaining the integrity of SBA's programs and determinations.

OHA also provides small businesses with a less expensive alternative than appealing SBA determinations directly to Federal court. The administrative appeals process OHA provides thus lessens the burdens on small businesses and ensures a more robust self-policing enforcement mechanism. Since the health of the industrial base requires a timely, inexpensive way to ensure that small businesses are indeed small, a strong and healthy OHA will promote a strong and healthy industrial base. Unfortunately, there is currently one significant impediment to a strong OHA, and there are two other ways OHA could be improved. These will now be discussed.

#### **b. OHA Is Not In Statute**

The principal challenge to the health of OHA comes from the fact that OHA only exists in regulation, not in statute. This fact makes OHA less independent in practice than it otherwise could be. For example, SBA can chip away at OHA's jurisdiction by drafting regulations that remove these jurisdictional areas to other parts of the agency. Such encroachment lessens OHA's independence and, in theory, makes OHA less likely to reverse SBA decisions. The Subcommittee therefore seeks testimony on whether OHA should be a statutory creature.

#### **c. NAICS Shopping**

In addition to the fact that OHA does not exist in statute, OHA is not able to address two crucial issues for small businesses. The first deals with the misapplication of NAICS codes. As previously mentioned, OHA decides appeals of NAICS codes. To be eligible for Federal contracts set aside for small business, a small business must not exceed the size standard designated to the procurement.<sup>124</sup> SBA's designates a size standard for each NAICS code.<sup>125</sup> These size standards are based on a firm's annual receipts or its number of employees, and the size standards measured in receipts-based standards range from \$750,000 to \$38.5 million while employee-based size standards range from 50 employees to 1500 employees.<sup>126</sup> A contracting officer for any procurement must assign the NAICS code that the contracting officer believes best describes the principal purpose of the product or service being acquired in light of the industry descriptions in the *NAICS Manual*, the description in the solicitation, and the function of the goods or services being acquired.<sup>127</sup>

If a small business believes the contracting officer designated the incorrect NAICS code, the small business may appeal the designation to OHA within 10 calendar days after the issuance of the solicitation.<sup>128</sup> SBA regulations provide that a firm must be "adversely affected" by the designated NAICS code to have standing to appeal it.<sup>129</sup> OHA has interpreted this requirement to mean that the aggrieved party "must show that it is a potential bidder or offeror on a small business set-

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<sup>124</sup> See 13 C.F.R. § 121.101(a).

<sup>125</sup> *Id.*

<sup>126</sup> See generally, *id.* § 121.201.

<sup>127</sup> *Id.* § 121.402(b).

<sup>128</sup> Federal Acquisition Regulations (FAR) 19.303(c); 13 C.F.R. §§ 121.1103(b)(1), 134.304(b).

<sup>129</sup> 13 C.F.R. §§ 121.402(e), and 134.302(b).

aside.”<sup>130</sup> Specifically, where a firm is not small under the NAICS code designated in the solicitation and the NAICS code it seeks on appeal, OHA has determined that the firm has no standing to file a NAICS code appeal.<sup>131</sup> OHA’s practice of denying standing to large firms has potentially decreased contracting opportunities for small businesses, thereby harming the industrial base, in four important ways: loss of subcontracting opportunities; loss of competition; over reporting of the small business goals; and undermining the entire process for setting size standards.

### **i. Loss of Subcontracting Opportunities**

First, where a procurement is not set aside for small businesses and competition is unrestricted, the contractor must submit a small business subcontracting plan describing the efforts the contractor will make to ensure small businesses have the opportunity to compete for subcontracts.<sup>132</sup> Where the procurement is set aside, however, the small business prime contractor need not submit a subcontracting plan because the limitation on subcontracting clause insures that over half of the dollars will remain with small businesses.<sup>133</sup> However, this trade-off only works if the correct NAICS code or a smaller NAICS codes is used. If a too-large NAICS code is used, true small businesses are often too small to compete as prime contractors, and there is no obligation for the successful large contractor to provide subcontracting opportunities for true small businesses. Thus, fewer dollars are flowing to legitimate small businesses.

This problem is not a mere hypothetical. Contracting agencies erroneously designate a NAICS code with a very large size standard, and therefore count procurements as prime contracts awarded to small business when they should not. For example, a review of recent procurements reveals significant overuse of a NAICS code in Industry Sector 54—Professional, Scientific, and Technical Services. This sector contains 47 NAICS codes, and most of their corresponding size standards range from \$7 million to \$27.5 million. One NAICS code in Industry Sector 54, though, contains a size standard much larger than the rest. NAICS code 541712, Research and Development in the Physical, Engineering, and Life Sciences (except Biotechnology) has a corresponding size standard of 500 employees. Further, the NAICS code contains three exceptions, two of which have a size standard of 1,000 employees: (1) Aircraft Parts, and Auxiliary Equipment, and Previous Aircraft Engine Parts; and (2) Space Vehicles and Guided Missiles, their Propulsion Units, their Propulsion Units Parts, and their Auxiliary Equipment and Parts. The third exception, Aircraft, has a size standard of 1500 employees.

Employee-based size standards are much larger than the largest receipts-based size standards.<sup>134</sup> As a result, if a contracting agency can issue a contract for professional, scientific, and technical services under a NAICS code with an employee-based size standard, the contracting agency can count still count this procurement towards its small business contracting goals while awarding the

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<sup>130</sup> *NAICS Appeal of Rotech Healthcare, Inc.*, SBA No. NAICS-5550 (2014).

<sup>131</sup> *Id.*; *NAICS Appeal of Am. Sys. Corp.*, SBA NAICS-5060 (2009); *NAICS Appeal of Spendida Prop. Sys., LLC*, SBA No. NAICS-4576 (2003).

<sup>132</sup> FAR 19.702 and 704.

<sup>133</sup> FAR 19.702(b).

<sup>134</sup> Analysis based on the revenue per employee of the NASDAQ 100 firms in 2009, *available at* <http://blog.jbryanscott.com/post/63322581773/nasdaq-100-revenue-per-employee> (last accessed February 26, 2015). The average revenue per employee was \$500,760. Thus, a firm with 500 employees could have annual receipts of over \$250 million.

contract to a firm whose receipts exceed any receipts-based size standard. The presence, then, of size standards ranging from 500 to 1500 employees in Sector 54 has led to many contracting agencies designating NAICS code 541712 to procurements that do not actually call for research and development. Thus, an agency seeking to meet its prime contracting goals could label contracts under these exceptions and take credit for small business awards without actually engaging small businesses.

In reviewing recent procurements for which NAICS code 541712 was assigned, 7% (13 out of 176) were improperly issued under this NAICS code.<sup>135</sup> These awards represent hundreds of millions of taxpayer dollars erroneously awarded and coded as small business set asides, where there was no requirement that dollars be spent with actual small businesses.

### **ii. Loss of Competition**

While small businesses lost opportunities to compete as subcontractors on these contracts, the taxpayers also lost an opportunity to maximize competition. As previously explained, using a NAICS code with a size standard that dwarfs the correct size standard means that true small businesses are too small to compete as prime contractors. However, since the work is not competed using full and open competition, only the smaller large businesses can compete – the largest small businesses are still prohibited from submitting offers. If these procurements were unrestricted, all these companies would have been allowed to compete for the work, potentially saving taxpayer dollars.

### **iii. Undermining the Small Business Goals**

As previously discussed, SBA tracks and reports on the utilization of small businesses each year. However, if the SBA counts work under a too-large size standard as work awarded to a legitimate small business, it undermines the entire goaling process. For example, for every million dollars incorrectly labeled as awarded to small businesses, that is a million dollars agencies do not need to award to legitimate small businesses in order to meet the goals. It also means that SBA and the federal government do not have a strong grasp on where opportunities exist for small businesses, and where additional work needs to take place to create opportunities for competition. It camouflages holes in the industrial base, which only further exacerbates vulnerabilities.

### **iv. Undermining the Creation of Size Standards**

According to its a Size Standards Methodology, SBA relies upon five primary industry factors to establish its size standards.<sup>136</sup> Four of these factors are economic characteristics of the industry: average firm size, startup costs and entry barriers, industry competition, and distribution of firms by

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<sup>135</sup> See Solicitation Nos. FA8075-15-R-0001 (max. award \$2 billion), NNA14502291R-MZM (max. award \$38 million), NNL15ZB1002R (partial set-aside; max. award \$101 million), NNA14ESTRAD-ACR (max. award \$43 million), N61331-14-T-8591, FA2486-14-R-0002, FA7000-14-T-0032 (sole source), CL14-KD4007 (sole source), NIH-NICHD-DESPR-2013-15 (cost reimbursement), FA4890-13-R-0104 (max. award \$21 million), FA8621-13-R-6304, NIH-NICHD-CPR-2012-07, and FA4600-09-R-0004 (max. award \$34 million), available at <https://www.fbo.gov/?s=opportunity&mode=list&tab=searchresults> (last accessed February 26, 2015).

<sup>136</sup> 74 Fed. Reg. 53940 (2009).

size<sup>137</sup> Additionally, and perhaps most relevant here, SBA's fifth factor examines the impact of an existing size standard on small business contracting, and it will change a size standard in response to the participation of small businesses in federal contracting.<sup>138</sup> Therefore, if contracts are incorrectly labeled as being set aside for small business, it distorts the very data SBA uses to create the correct size standards. Consequently, misapplication of size standards reduces opportunities for current and future small businesses to obtain contracts.

#### v. Issues for Consideration

Despite these four challenges, there is not a mechanism available that allows large businesses to argue that a NAICS code with a large size standard does not describe the work to be performed, because SBA does not allow large firms to appeal NAICS codes or argue that the procurement should be unrestricted.<sup>139</sup> Where the procurement in question is for a complex and wide range of tasks that could not be completed by a business with annual receipts less than \$25.5 million, the exclusion of NAICS appeals from large businesses thus silences argument from the only party incented to protest.

One bridge in this gap is a regulation allowing SBA to bring NAICS appeals to OHA any time before proposals are due.<sup>140</sup> SBA, however, has not been diligent in monitoring for abuse of NAICS code 541712. SBA has only ever filed three NAICS appeals, and none challenged the designation of NAICS code 541712.<sup>141</sup> There is also an important question as to whether it is in the best interest of small businesses to have SBA challenging the decision to set aside a procurement, when so many decisions to not set aside a procurement are not reviewed and the private sector could fulfill this burden. Therefore, to create more avenues for challenging improper NAICS codes and set-asides, the Subcommittee seeks testimony on whether large businesses should have the opportunity to file a NAICS code appeal at OHA.

The Subcommittee also hopes that the witnesses will address the appropriate timeline for filing a NAICS appeal. Currently, potential bidders are allowed to bring a NAICS appeal to OHA within 10 calendar days of the issuance of the solicitation.<sup>142</sup> The standard of review for overturning a NAICS designation is whether the contracting officer clearly erred in designating the NAICS code that best describes the principal purpose of the product or service being acquired.<sup>143</sup> The real motivation for filing a NAICS appeal, though, is to widen or constrict the pool of eligible bidders through changing the size standard.<sup>144</sup> As a result, potential bidders often bring disingenuous arguments over the procurement's primary purpose in an effort to bring about a size standard that

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<sup>137</sup> 13 CFR § 121.102(a).

<sup>138</sup> *Id.*

<sup>139</sup> *Supra*, n.8.

<sup>140</sup> 13 C.F.R. §§ 134.302(b) and 134.304.

<sup>141</sup> See *NAICS Appeal of SBA*, SBA No. NAICS-5526 (2014); *NAICS Appeal of SBA*, SBA No. NAICS-5526 (2013); *NAICS Appeal of SBA*, SBA No. NAICS-5399 (2012).

<sup>142</sup> *Supra*, n.5.

<sup>143</sup> 13 C.F.R. § 134.314; *NAICS Appeal of Allserv, Inc.*, SBA No. NAICS-5629, at 6 (2014).

<sup>144</sup> Steven Koprince, *See Ya! Contractor Wipes Out Two-Thirds of Its Potential Competitors with Successful NAICS Appeal*, SmallGovCon (Jun. 23, 2011), <http://smallgovcon.com/sbaohadecisions/see-ya-contractor-wipes-out-two-thirds-of-its-potential-competitors-with-successful-naics-appeal/#sthash.jx1hUyiK.dpuf> (last accessed February 26, 2015).

boosts their competitiveness.<sup>145</sup> Potential bidders have even argued that contracting officers also have an interest in choosing a NAICS code with a higher size standard, as it allows larger, more experienced firms to compete.<sup>146</sup>

These misaligned incentives often result in meritless NAICS appeals that prolong the procurement process. Contractors spend significant resources pursuing a contract and submitting their bids and proposals, and because NAICS appeals are not final until the window for appealing to OHA has passed, the NAICS code and size standard—and the pool of eligible bidders—are uncertain. This uncertainty can hamper contractors’ willingness to submit bids and may therefore reduce competition.

Unlike potential bidders, and possibly contracting officers, OHA does not have an interest in designating a NAICS code based on its size standard. Thus, the Subcommittee seeks opinions on whether OHA should allow a pre-solicitation NAICS appeal process where, at the request of the contracting officer, OHA may designate the NAICS code and size standard applicable to any government procurement or sale. Any testimony on this issues should discuss the effect of pre-solicitation appeal on a subsequent post-solicitation appeal.

#### **d. Size Standards**

As alluded to early, SBA formalized its process for establishing size standards in 2011 when it published a white paper titled “Size Standards Methodology” detailing the five primary industry factors considered when establishing size standards.<sup>147</sup> Prior to 2011, there were roughly 1100 NAICS codes and 41 separate size standards. SBA then proposed selecting size standards from a limited number of fixed size standards: eight revenue-based standards and eight employee-based size standards.<sup>148</sup> Subsequently, there was an outcry from industry,<sup>149</sup> and the Committee held a hearing to create a record of their concerns.<sup>150</sup> SBA proceeded nevertheless to combine industries and limit size standards. This prompted the Committee to report H.R. 3987, the Small Business Protection Act of 2012, which later became law as section 1661 of the National Defense Authorization Act for Fiscal Year 2013 (FY 13 NDAA).<sup>151</sup>

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<sup>145</sup> *E.g.*, *NAICS Appeal of Microtechnologies, LLC*, SBA No. NAICS-5489 (2013) (finding the contracting officer did not err in designating NAICS code, 541519, Other Computer Related Services, Information Technology Value Added Resellers, with a corresponding 150-employee size standard and denying the request to change the NAICS code to 517110, Wired Telecommunications Carriers, with a 1500-employee size standard).

<sup>146</sup> *E.g.*, *NAICS Appeal of Pac. Shipyards Int’l, LLC*, SBA No. NAICS-5464, at 3 (2013); *see also* Steven Koprince, *SBA OHA: Increased Competition Not Part of NAICS Code Decision*, SmallGovCon (Jun. 4, 2013), available at <http://smallgovcon.com/sbaohadecisions/sba-oha-increased-competition-not-part-of-naics-code-decision/#sthash.8eRRw1YQ.dpuf> (last accessed February 26, 2015).

<sup>147</sup> *Supra*, n.36. The full methodology is available at [https://www.sba.gov/sites/default/files/size\\_standards\\_methodology.pdf](https://www.sba.gov/sites/default/files/size_standards_methodology.pdf) (last accessed February 26, 2015).

<sup>148</sup> Small Business Size Standards: Professional, Scientific and Technical Services, 76 Fed. Reg. 14,323, 14,327 (2011).

<sup>149</sup> *Id.*

<sup>150</sup> *Professional Services: Proposed Changes to the Small Business Size Standards; Hearing before the Small Business Committee Subcommittee on Economic Growth Capital Access and Tax*, 112th Cong. 66-748 (May 5, 2011).

<sup>151</sup> H. Rept. 112-724 (2012).

The FY 13 NDAA altered the SBA's ability to establish size standards in three important ways. First, Section 3(a) of the Small Business Act (Act) was amended to add a new paragraph (6) addressing the minimum requirements of rulemaking pertaining to any size standards.<sup>152</sup> Second, a new paragraph (7) was added to explicitly address the use of common size standards.<sup>153</sup> Finally, paragraph (8) was added to address the number of size standards.<sup>154</sup>

With these amendments, Section 3(a) of the Act now reads:

**(6) Proposed rulemaking**

In conducting rulemaking to revise, modify or establish size standards pursuant to this section, the Administrator shall consider, and address, and make publicly available as part of the notice of proposed rulemaking and notice of final rule each of the following:

- (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 rule making; 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 rule making and the number of concerns currently considered small that would be deemed other than small under the proposed rulemaking.

**(7) Common size standards**

In carrying out this subsection, the Administrator may establish or approve a single size standard for a grouping of 4-digit North American Industry Classification System codes only if the Administrator makes publicly available, not later than the date on which such size standard is established or approved, a justification demonstrating that such size standard is appropriate for each individual industry classification included in the grouping.

**(8) Number of size standards**

The Administrator shall not limit the number of size standards established pursuant to paragraph (2), and shall assign the appropriate size standard to each North American Industry Classification System Code.<sup>155</sup>

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<sup>152</sup> 15 U.S.C. § 632(a)(6), as amended by Pub. L. No. 112-239 § 1661, 126 STAT. at 2083.

<sup>153</sup> 15 U.S.C. § 632(a)(7), as amended by Pub. L. No. 112-239 § 1661, 126 STAT. at 2084.

<sup>154</sup> 15 U.S.C. § 632(a)(8), as amended by Pub. L. No. 112-239 § 1661, 126 STAT. at 2084.

<sup>155</sup> 15 U.S.C. § 632(a)(6)-(8).

Unfortunately, as will now be discussed, SBA continues to propose rules that contradict these provisions of the amended statute. SBA's proposed rules therefore cannot withstand judicial scrutiny.<sup>156</sup>

On September 10, 2014, SBA proposed regulations to modify the size standards for 30 industries and three sub-industries that have employee-based size standards.<sup>157</sup> Congressman Sam Graves, then Chairman of the Committee, urged SBA to withdraw the proposed rule. Congressman Graves argued that the proposed rule violates Section 3(a)(6) of the amended statute because it does not take into account the effects of its rulemaking on the industry.<sup>158</sup> Further, it violates Section 3(a)(7) because it provides no justification for its reliance on common size standards.<sup>159</sup> Finally, it violates Section 3(a)(8) because it limits the number of size standards.<sup>160</sup> Because the proposed rule is contrary to statute, it is not rational, as the Administrative Procedure Act requires.<sup>161</sup>

In response to the Committee's comments, SBA sent a letter dated December 4, 2014, that stated that the next version of its goaling guidelines will incorporate the FY 2013 changes, and that these will apply to size standards as early as FY 2017.<sup>162</sup> However, this does not address the problems created for firms covered by the proposed rule, or proposed rules issued prior to SBA revising its guidance. Hundreds of thousands of small contractors will be governed by these size standards, and SBA suggests abandoning them to the status quo.

Indeed, even with a revised size standard methodology, there is no provision for notice and comment rulemaking, or any way of challenging a poor final rule other than resorting to the courts. As these size standards are key to the ability of small businesses to compete for contracts, and therefore to the health of the industrial base, the Subcommittee seeks testimony on whether an administrative remedy is warranted. Specifically, the Subcommittee wishes to consider whether Congress should provide OHA with the ability to hear challenges brought by firms adversely affected by SBA promulgating size standards that do not abide by the Act.

## **V. Conclusion**

As previously noted, the small business industrial base is in crisis. This Subcommittee will consider whether legislative changes could better protect and promote these businesses. In doing so, the Subcommittee seeks greater competition, innovation, and job creation.

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<sup>156</sup> *Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837, 844 (1984).

<sup>157</sup> Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, 79 Fed. Reg. 53,646 (proposed Sept. 10, 2014) (to be codified at 13 C.F.R. § 121.201).

<sup>158</sup> Chairman Graves Comment on Proposed Rule, 6-9, available at <http://www.regulations.gov/#!documentDetail:D=SBA-2013-0010-0210> (last accessed February 18, 2015).

<sup>159</sup> *Id.* at 9-10.

<sup>160</sup> *Id.* at 10-11.

<sup>161</sup> 5 U.S.C. §§ 500, *et seq.*

<sup>162</sup> Letter on file with the Committee.

Chart 1. Category Management

# The Potential Universe of Commonly Purchased Goods and Services Valued at \$277B in FY 13

<b>1. IT</b>	<b>\$47.4B</b>	<b>2. Professional Services</b>	<b>\$64.6B</b>	<b>3. Security and Protection</b>	<b>\$4.8B</b>	<b>4. Facilities &amp; Construction</b>	<b>\$72.1B</b>	<b>5. Industrial Products and Services</b>	<b>\$11.8B</b>
1.1 IT Software		2.1 Business Administration Services		3.1 Security Animals & Related Services		4.1 Construction Related Materials		5.1 Machinery & Components	
1.2 IT Hardware		2.2 Legal Services		3.2 Security Systems		4.2 Construction Related Services		5.2 Fire/Rescue/Safety/Environmental Protection Equipment	
1.3 IT Consulting		2.3 Management Advisory Services (Excludes R&D 17.0)		3.3 Security Services		4.3 Facility Related Materials		5.3 Hardware & Tools	
1.4 IT Security		2.4 Marketing and Distribution				4.4 Facility Related Services		5.4 Test & Measurement Supplies	
1.5 IT Outsourcing		2.5 Public Relations and Professional Communications Services				4.5 Facilities Purchase & Lease		5.5 Industrial Products Install/Maintenance/Repair/Rebuild	
1.6 Telecommunications		2.6 Real Estate Services						5.6 Basic Materials	
		2.7 Trade Policy and Services						5.7 Oils, Lubricants, and Waxes	
		2.8 Technical and Engineering Services (non-IT) (Excludes 1.0)							
		2.9 Financial Services							
		2.10 Social Services							
<b>6. Office Management</b>	<b>\$2.1B</b>	<b>7. Transportation and Logistics Services</b>	<b>\$34.1B</b>	<b>8. Travel and Lodging</b>	<b>\$3.6B</b>	<b>9. Human Capital</b>	<b>\$3.6B</b>	<b>10. Medical</b>	<b>\$33.2B</b>
6.1 Office Management Products		7.1 Package Delivery & Packaging		8.1 Passenger Travel		9.1 Alternative Educational Systems		10.1 Drugs and Pharmaceutical Products	
6.2 Office Management Services		7.2 Logistics Support Services		8.2 Lodging		9.2 Educational Facilities		10.2 Medical Equipment & Accessories & Supplies	
6.3 Furniture		7.3 Logistics Civil Augmentation Program		8.3 Travel Agent & Misc. Services		9.3 Educational Institutions		10.3 Healthcare Services	
		7.4 Transportation of Things				9.4 Specialized Educational Services			
		7.5 Motor Vehicles (non-combat)				9.5 Vocational Training			
		7.6 Transportation Equipment				9.6 Human Resources Services			
		7.7 Fuels							

Source: OMB, <http://www.whitehouse.gov/blog/2015/01/07/taking-category-management-government-wide-0>.