

Testimony of

Damien Specht

Partner

Jenner & Block, LLP

Co-Chair, Government Contracts Corporate Transactions Practice Group

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE

Regarding “Contracting and Industrial Base II: Bundling, Goaling, and the Office
of Hearings and Appeals”

March 17, 2015

Chairman Hanna, Ranking Member Velazquez and Members of the Subcommittee, thank you for the invitation to appear today. It is a privilege to share my views on the ways we can maintain a strong industrial base of small business government contractors. My name is Damien Specht, and I am a government contracts partner with the law firm of Jenner & Block here in Washington, D.C. Before I begin, let me state that my comments are my own, and I am not speaking on behalf of my law firm or any specific client.

I serve as Co-Chair of the firm's Government Contracts Corporate Transactions Practice Group and as a Co-Chair of the American Bar Association's Section of Public Contract Law Small Business & Other Socioeconomic Programs committee. In each of these roles, I work with small government contractors and entrepreneurs as they enter the federal market, navigate size protests, and, through hard work, develop thriving mid-size businesses. I also assist small businesses in corporate transactions with large contractors and investors.

In my testimony, I will address how consolidated contracting, whether through bundling or strategic sourcing, reduces competition and necessarily limits the number of small businesses in the federal marketplace. I would also like to briefly discuss the Small Business Administration's scorecard rating methodology and, as a litigator who regular appears before the Small Business Administration Office of Hearings and Appeals, share some thoughts on that forum.

Bundling Reform

Anecdotally, I have heard from many of my small business clients that bundling is a problem. For example, facilities operation contractors have complained that general maintenance services have been bundled with logistics and food services and hardware contractors have been excluded from competitions when a series of additional items were added

to the contract requirements. However, because we largely rely on self-reporting, the government has little reliable data on where bundling is occurring, how many contractors are being affected by bundling, and the impact that bundling and consolidation are having on the small business community.

As a result, I support the efforts of this subcommittee to increase transparency and reporting of data related to bundling. In particular, I support the idea that agencies should be required to publish bundling justifications along with issued solicitations. In other circumstances where agencies limit competition, such as sole-source awards, we require publication of a justification; bundled requirements, which can eliminate small business opportunities, should be no different. This added transparency will allow small businesses to understand the agency's rationale and, if necessary, to protest the consolidated requirement.

I will note, however, that bundling protests are rarely successful. I have reviewed dozens of protest decisions by the Government Accountability Office that include bundling allegations and could only find a small handful that were sustained on that basis. This is the case because the GAO gives agencies significant deference and only requires "a reasonable basis for its contention that bundling is necessary."¹ This is not a high bar and, as result, it appears that the primary way for an agency to lose a bundling protest is to fail to perform the statutorily required bundling analysis at all.² As a result, in addition to increasing transparency surrounding bundling, this committee should consider raising the bar for justifying these decisions, which can currently be based on as little as a five percent cost savings.³

¹ *B.H. Aircraft Company, Inc.*, B-295399.2, July 25, 2005, 2005 CPD ¶ 138.

² *Sigmattech, Inc.*, B-296401 Aug. 10, 2005, 2005 CPD ¶ 156 (sustaining a protest "where agency failed to perform bundling analysis").

³ Currently, FAR 7.107 provides that bundling may be permissible if it results in "cost savings or price reduction, quality improvements that will save time or improve or enhance performance or

The Downside of Strategic Sourcing

Although strategic sourcing is technically consolidation and not bundling, it can have the same effect of weakening the small business government contracting base.

Strategic sourcing means many things to many people, but the basic process includes identifying needs across government agencies and consolidating purchases through industry or item-focused contract vehicles to achieve cost savings. The public record is clear that proponents of strategic sourcing have worked with small business stakeholders to maximize small business participation on these contracts. In fact, most of the awardees under the GSA's Federal Strategic Sourcing Initiative (FSSI) program are small businesses. That effort is commendable, but the problem with strategic sourcing is not one of intent or lack of effort to include the small business industrial base. The problem is that strategic sourcing, at least when accomplished through large contract vehicles, is necessarily bad for enhancing the diversity of small government contractors in the industrial base. This is the case for a few reasons:

First, the number of offerors that can compete for strategic sourcing contracts is limited. As a result, it is not at all clear that the Government is getting the best pricing on each item or that it is honoring its commitment to full and open competition. When the government's solicitation requires offerors to provide hundreds of different items in significant bulk, as it must to gain the benefits of a strategic sourcing contract, that contract structure all but eliminates offerors who provide some of the required items but cannot deliver in the tremendous quantities required for a government-wide purchasing vehicle. As demonstrated by the FSSI Office

efficiency, reduction in acquisition cycle times, better terms and conditions, and any other benefits." Cost savings must be substantially equivalent to "(1) Ten percent of the estimated contract or order value (including options) if the value is \$94 million or less; or (2) Five percent of the estimated contract or order value (including options) or \$9.4 million, whichever is greater, if the value exceeds \$94 million." *Id.*

Supplies contract, it is often necessary for hundreds of small businesses to team together to fulfill the requirements of these large contracts. As you might imagine, these broad coalitions among competitors are rare and result in significant administrative challenges. This is a real barrier to entry for small businesses that could provide some, but not all, items or lack the immediate infrastructure to deliver hundreds of thousands of items. These same small businesses could fulfill the government's needs if smaller, more focused contracts were opened for competition among the full breadth of the small business base.

Second, those businesses that do not receive strategically sourced awards may find other contract opportunities disappear. To drive real volume discounts, purchasing from strategic sourcing vehicles, like the FSSI contracts, must be mandatory or, at least, highly encouraged. That means that there are a small number of significant winners and a far larger number of losers.

For example, in June 2010, GSA awarded the previous generation of its FSSI Office Supply blanket purchase agreement to 15 companies. Although there were 15 awardees, most of which were small businesses, those awardees must be balanced against the thousands of possible firms that could have met the Government's needs had these requirements been solicited in less volume. This number includes 569 holders of GSA Schedule for Office Solutions that could have met the Government's needs through a simple Federal Supply Schedule order. All of those other businesses, large and small, became holders of an essentially useless supply schedule contract.

As this example demonstrates, small business participation percentages reported as part of strategic sourcing do not report the whole story. For example, GSA has reported that small

business participation on its office supply contracts increased from 67 percent to 76 percent of spending in fiscal year 2014. If the goal of small business programs were simply to achieve certain metrics, these numbers would show clear and convincing progress. However, I believe that the purpose of small business programs is to create a vibrant and diverse base of small businesses that can offer innovation and creativity to the federal marketplace while creating jobs in communities across the country. Judged by that standard, a higher percentage of spending that is isolated within a smaller number of firms is not a step in the right direction.

Third, because strategic sourcing contracts are likely to reduce the number of sales available to Federal Supply Schedule holders, these large contracts may also dissuade small business from becoming federal contractors. Traditionally, GSA's Federal Supply Schedule program has provided a low barrier to entry access point for aspiring government contractors. In fact, the overwhelming majority of my small business clients hold at least one Federal Supply Schedule contract. The appeal of these contracts is obvious: Instead of putting together RFP responses for specific procurements and expending significant bid and proposal costs, a small contractor looking to enter the federal space can put together a single schedule proposal and place its entire catalog online. If this low-cost entry is successful, the firm can then expand its offerings and compete for other federal contracts. If we choose to shift the Government's purchases to strategic sourcing contracts and away from the rest of Federal Supply Schedule holders, as appears to be the case, this small business entry point will be less attractive, and we will lose a significant number of possible federal contractors.

Fourth, the award of a strategic sourcing contract is not always a benefit to the winners. This is the case because large awards can set up a "hill and valley" problem for small contractors. A small business that receives millions in strategic sourcing awards over the

contract term is likely to expand its infrastructure and employee base to meet those needs. However, a firm that remains dependent on a single contract for a large portion of its revenue may be unable to maintain that infrastructure if it is unable to win the next iteration of that contract. As a result, there is the real risk that today's winners will face significant difficulties in a few years when these large awards have expired, while a business that receives regular, but smaller, awards under a traditional contracting model will not face the same challenges.

In summary, there is nothing inherently wrong with strategic sourcing or purchasing in bulk through large multiple-award contracts. However, this committee needs to look beneath the surface of overall small business participation numbers and judge whether these actions are consistent with stated small business policy goals, such as building a diverse small business base.

Agency Scorecards

Despite the impact of bundling and consolidation, the Federal Government met its overall small business goals (and many subcategory goals) in fiscal year 2013. It appears that feat was repeated in 2014. These are not minor achievements. For years, many of us in the private bar assumed that the failure to meet small business goals was going to be the status quo. Now, we are hopefully at the beginning of a new normal where these goals are achieved on a regular basis.

This accomplishment is tempered by persistent concerns that large contractors are receiving set-aside awards and being counted toward small business goals. In my time working in this area, I have seen instances where public records indicated a set-aside award to a contractor that may not have been a small business during the relevant period. Although these may have been honest mistakes or data entry errors, continued training of contracting officers and explanation of

the complicated small business rules to the contracting community will be helpful in confirming that the proper numbers are being reported.

Further, although achievement of the overall small business goal is unquestionably good news, there is still room for improvement on an agency by agency basis. As a result, it is somewhat misleading for SBA to assign an “A” or “A+” rating to 20 of the 24 agencies reviewed. This is particularly troubling when no agency hit all of its goals. For example, eight agencies received an overall “A” grade while failing to meet their overall small business subcontracting goal.⁴ One of those agencies, the Department of the Treasury, was assigned an “A” rating despite subcontracting to small business at only a 6.8% rate. The SBA’s underweighting of small business subcontracting goals is not a mistake. SBA’s stated grading formula weights prime contract goals achievement as eight times more important than subcontracting goals. Although I agree that prime contract opportunities may be more beneficial to small businesses, it is not clear why the weighting disparity should be this significant.

Despite the details of SBA’s weighting formula, agencies should be congratulated for their efforts in meeting the government’s overall small business goal. However, this committee should continue to closely examine the basis for those grades to determine where this performance can be improved.

⁴ Each of the Department of Veterans Affairs, State Department, Department of Treasury, Small Business Administration, Department of Homeland Security, Agency for International Development, Department of Education and Department of Health and Human Services received an overall “A” grade while missing their overall small business subcontracting goal.

Office of Hearings and Appeals

Shifting to my role as a small business litigator, I would like to address a couple of issues related to SBA's Office of Hearings and Appeals (OHA) that are important to small contractors.

Although I certainly do not agree with every decision issued by OHA, there is no doubt that it has proven to be an efficient alternative to full-scale litigation in federal court. As a result, I support making OHA permanent through statute. Any such statute should, of course, recognize that small businesses may appeal OHA decisions to federal court if they so choose.

Action to formalize the existence of OHA should also eliminate an unnecessary redundancy in the Small Business Act. Specifically, although OHA's administrative judges have developed significant small business expertise, the Small Business Act assigns certain appeals, including those related to 8(a) program admission and termination, to Administrative Law Judges (ALJs), of which OHA currently has none.⁵ This has led to a peculiar arrangement where, pursuant to an Interagency Agreement in effect beginning October 1, 2012, ALJs at the U.S. Department of Housing and Urban Development hear these cases on behalf of SBA. Although I have no doubt that this arrangement is effective, it makes more sense to centralize small business decisions in OHA as a free-standing statutory entity.

I also understand that the committee is considering expanding OHA's jurisdiction to include pre-solicitation requests from the contracting officer that OHA assign an appropriate NAICS code. This would be a significant change from OHA's current rule, which allows NAICS code appeals only after a solicitation has been issued. An expansion of OHA's jurisdiction in this manner raises a number of concerns that should be addressed.

⁵ See 15 U.S.C § 637(a)(9)(A).

It is my belief that the contracting officer is in the best position to understand the nature of a given procurement beyond the text of the solicitation. As a result, the contracting officer should be charged with assigning the correct NAICS code to a solicitation in the first instance and should not be allowed to delegate that decision to OHA.

Further, allowing such a delegation could create a scenario where contracting officers may seek to “protest-proof” each solicitation by running it through OHA. This would, of course, overwhelm OHA with unnecessary cases.

Finally, I believe that the NAICS code appeal process benefits from the input of small business contractors. This process could be undercut by a pre-solicitation process initiated by the contracting officer. Whether they are protesters or intervenors, small businesses must be allowed to review the text of a final solicitation to raise different perspectives and applicable NAICS codes to OHA. In fact, it may be beneficial to expand the filing deadline for NAICS appeals, which currently stands at 10 days after issuance of a solicitation, to allow small businesses to become aware of and review the extensive solicitations that support modern procurements.

Conclusion

In conclusion, I would like to commend this committee for going beyond small business metrics to focus on the diversity of a healthy small business subcontracting base. I look forward to your questions.