



FEDERAL CONTRACTS



REPORT

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Small Business

Concrete Steps Government Should Take to Alleviate Growing Procurement Challenges for Small Businesses



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For more than fifty years, it has been the policy of the federal government to enhance contracting opportunities for small businesses.¹ Federal agencies are expected to meet broad set-aside goals that provide prime contracting opportunities for small and disadvantaged businesses, and require large contractors to follow small business subcontracting plans to ensure that small contractors remain active and competitive in the government marketplace. These objectives recognize that the government’s best interests are served when there is a robust small business contracting community.

In an April 2010 memorandum establishing a Small Business Task Force,² President Obama reaffirmed the important contribution that small businesses make to the federal government and the American economy. The President explained that small businesses “should be able to compete and participate effectively in Federal contracts” and that “where small businesses have the capacity to do more, we should strive to exceed the statutory goals” for small business contracting. President Obama also reiterated that “small business contracting should always be a high priority in the procurement process.”

Despite good intentions, the government is not taking practical steps that could actually improve small business contracting. In fact, in many instances, the current

¹ Small Business Act, Public Law 85-536, as amended.

² “Presidential Memorandum on the Interagency Task Force on Federal Contracting Opportunities for Small Businesses,” April 26, 2010.

administration is implementing practices that are having a significant and adverse impact on small businesses. There is perhaps no better example than the administration's sweeping in-sourcing goals, as small businesses are increasingly and disproportionately losing jobs and employees to the public sector—at a higher total cost to the taxpayers.

If the administration is serious about the importance of small businesses to the growth and recovery of the American economy,³ the government could take several immediate steps to grow and strengthen small businesses in the area of government contracting.

Stop In-Sourcing Contractor Employees. Small businesses know all too well that the federal government is in-sourcing jobs at an increasing and disturbing rate. In March 2010, the Office of Federal Procurement Policy issued a proposed “policy letter”—which, when finalized, will be codified in the Federal Acquisition Regulation—to provide regulatory guidance with respect to when certain functions should be performed by federal employees.⁴ Although the purported objective of the policy letter is to ensure that only “inherently governmental functions” are performed by the public sector, the message of the letter is clear: agencies should broadly and actively in-source positions, not just those that are inherently government, but also those that are “closely associated” with inherently government functions and those that are “critical” to an agency's mission.

While the policy letter is in the process of being finalized, pending legislation will only make matters worse. The National Defense Authorization Act for FY 2011, H.R. 5136, which already passed the House, contains alarming provisions that signal in-sourcing will only increase. For example, Section 850 directs civilian agencies to review all service contracts awarded each year and report the nature of the work to the Office of Management and Budget. Among other things, the purpose of the review would be to ensure that, to the “maximum extent practicable,” functions that are closely associated with inherently governmental functions are not performed by contractors. The bill would also broadly mandate that “special consideration” be given to the use of federal employees.

Additionally, with respect to the Department of Defense, Section 326 would prohibit the consideration of employer contributions to health benefits and retirement plans for purposes of conducting a cost comparison to determine whether to convert a contractor position to a government position. This provision is remarkable in view of the fact that federal employees receive approximately four times as much in health and pension benefits than private sector employees.⁵ If the pur-

pose of a “cost comparison” is to determine whether contractor performance is cost effective, then it defies all reason that agencies would not consider the cost of federal benefits—a significant and real cost to the taxpayer. The fact that Congress wants to prohibit consideration of federal benefits when conducting cost comparisons suggests that government employees actually cost the taxpayer more than contractor employees.

These provisions are unmistakably intended to lead to more government jobs at the expense of the private sector. While all contractors are affected by in-sourcing, small businesses, in particular, are impacted in several important ways, such as:

- Economies of scale disfavor small contractors when positions are in-sourced. Small businesses cannot absorb the loss of revenue and talent to the same degree as large contractors.

- Small businesses rely heavily on the past experience of key personnel in obtaining new contracts. In-sourcing these positions and employees to the government can devastate a small business' ability to successfully compete for new work.

- As subcontractors, small businesses are often the first to lose positions when an agency in-sources work because large prime contractors will generally protect their own employees and take positions away from small businesses. There is little oversight over small business subcontracting goals post-award, and it is unlikely that agencies recognize the direct impact an in-sourcing decision will have on small business subcontractors.

If the administration is serious about enhancing small business contracting opportunities, and truly believes that small businesses create most of the new jobs in the economy, then the government should narrow the scope of its comprehensive in-sourcing policy.

End GSA Schedule Exemption from the Small Business ‘Rule of Two’ or Create a Price Preference in Favor of Small Businesses.

General Services Administration schedule contracting is one of the best ways small businesses can enter the federal marketplace or grow their existing government customer base. Unfortunately, GSA schedules are exempt from the mandatory “rule of two” under Federal Acquisition Regulation 19.502-2(b), which requires agencies to set-aside contracts worth less than \$100,000 to small businesses when there is a reasonable chance that two or more offers will be received from responsible contractors and the agency will obtain fair market prices. While approximately 80% of schedule holders are small businesses, small businesses currently receive only one-third of the nearly \$40 billion in schedule purchases each year.

Although the discount “catalog” pricing structure of GSA schedules has succeeded in streamlining the acquisition of commercial goods and services, it also necessarily favors larger businesses due to the economies of scale and the ability to offer deeper discounts. If the “rule of two” is applied to federal supply schedules, an

³ During President Obama's weekly radio address broadcast on July 31, 2010, the President insisted that “we [] need to stand shoulder-to-shoulder with America's small businessmen and women, as well—particularly since they're the ones who create most of the new jobs in this country.” See <http://www.whitehouse.gov/the-press-office/weekly-address-president-obama-hails-successes-restructuring-auto-industry-calls-go>.

⁴ Proposed OFPP Policy Letter No. 10-XX, “Work Reserved for Performance by Government Employees” (75 FR 16188-16197, March 31, 2010).

⁵ See, e.g., Cauchon, Dennis, “Federal pay ahead of private industry,” USA Today (March 8, 2010) (available at http://www.usatoday.com/news/nation/2010-03-04-federal-pay_N.htm); Edwards, Chris, “Overpaid Federal Workers,” Cato Institute (June 2010) (available at www.downsizinggovernment.org/overpaid-federal-workers) (reflecting an average benefit cost of approximately \$40,800 for federal workers in 2008 compared to only \$9,900 for the private sector).

estimated \$4 billion in additional contracting dollars would flow to small businesses, which would immediately further the president's stated objective of enhancing contracting opportunities for small businesses.

Alternatively, a GSA schedule price preference⁶ in favor of small businesses would have a tremendous and positive impact on small businesses. An evaluation preference would not exclude larger businesses from competing, but would enhance the likelihood of small businesses receiving awards under the schedules. Like the "rule of two," such a change in policy would significantly and immediately increase the federal dollars flowing to small businesses and assist agencies in meeting their statutory 23% small business contracting goals.

Enforce Small Business Subcontracting Plans. Small businesses frequently complain that agencies do not enforce prime contractor subcontracting plans once a contract is awarded. Prime contractors team with small businesses and tout their unique capabilities when submitting proposals, and are evaluated based on the completeness of their small business subcontracting plan and goals. However, once an agency awards the contract, prime contractors have little incentive to comply with the subcontracting plan. Small businesses are too often excluded from the share of work they anticipated when they teamed with a prime contractor.

If the federal government is serious about achieving its small business contracting goals, agencies should enforce the subcontracting plans submitted by prime offerors. Small business subcontracting plans should be mandatory performance requirements, and prime contractors should be held accountable for following their proposed plans absent a compelling reason. If a prime is unable to follow its subcontracting plan, it should be required to obtain permission from the contracting officer to deviate from the plan. Such a change in practice would go a long way toward enhancing contracting opportunities for small businesses.

Strengthen Anti-Bundling Rules and Provide Greater Transparency. Despite the fact that the FAR contains anti-bundling safeguards, many small businesses continue to lose contracting opportunities to large businesses when an agency "bundles" existing, smaller contract requirements into a single, large contract vehicle. Enforcement of existing rules and several changes to the regulatory framework would likely reduce inappropriate bundling and provide increased opportunities for small businesses to challenge agency bundling actions.

FAR 7.107(a) requires agencies to conduct market research to determine whether bundling is necessary and

justified. FAR 7.107(b) provides that bundling is necessary and justified when the government would derive "measurably substantial benefits," and that agencies "must quantify the identified benefits and explain how their impact would be measurably substantial." However, FAR 7.103(s) provides that agencies, when conducting acquisition planning, must contract requirements to facilitate competition among small business concerns and avoid unnecessary and unjustified contract bundling, but only "to the maximum extent practicable." FAR 10.001(c) also requires agencies to notify any affected incumbent small business of the agency's intention to bundle a requirement, but only states that agencies "should" consult with the local Small Business Administration (SBA) office when conducting market research.

The FAR should be revised to eliminate the "maximum extent practicable" language of FAR 7.103(s). If bundling is, in fact, "unnecessary and unjustified," then an agency should not bundle the requirements. Additionally, FAR 10.001(c) should be revised to require agencies to consult with SBA prior to bundling a procurement, rather than allow the consultation to remain discretionary. As an independent agency dedicated to enhancing contracting opportunities for small businesses, SBA will provide informed and impartial analysis to agency acquisition planners and provide alternative solutions that will reduce bundling.

Finally, we believe that agencies should make publicly available and post online the required analysis under FAR 7.107(b) in advance of issuing a solicitation. All small businesses, not just affected incumbents, should be aware of agency decisions to bundle contract requirements. Small businesses should be afforded a reasonable opportunity to examine the agency's written justification for bundling, determine whether the agency's actions are consistent with procurement law and regulations, and, if not, consider protesting the solicitation. A transparent process will go a long way toward ensuring that agencies are held accountable for unnecessary and unjustified bundling.

Conclusion. Small businesses are not only the largest employer in the United States, but they provide a diversity of ideas, strategies, skills, and experience that are invaluable to the government and taxpayer. It is in the government's best interest to have a broad, experienced industrial base. Moreover, a vital small business community is critical to the recovery and growth of the American economy. In most cases, a federal contract awarded to a small business generates more economic activity and growth and at a lower cost, than if the work is performed by the government. If small business contracting is a "high priority," the government should take meaningful steps to remove barriers to small business contracting opportunities and strengthen this important sector of the economy.

⁶ Such a price preference could be similar to the 12% mark-up applied under the Buy American Act for domestic small businesses. See FAR 25.105(b).