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An Overview of Small and Disadvantaged Business Contracting

by Paul J. Seidman

The federal government purchased a phenomenal \$170.1 billion in goods and services from both large and small businesses during fiscal year 1983 (FY 83). Of this amount, small business contractors received \$29 billion in prime contracts and \$20 billion in subcontracts, for a total of \$49 billion, or 28 percent of the total federal contract dollars. Although the small business share of federal procurement dollars is less than the small business share of gross national product (28 percent vs. 38 percent), the amounts involved are still considerable.¹

Federal contract work provides an important and continuing source of business for many small contractors, particularly new firms in high-technology areas. While the myriad rules and regulations governing the procurement process are often baffling in their complexity, many small firms find government work to be financially rewarding.

Most small businesses find it difficult, however, to participate in the federal procurement process. The fact is that most federal contracting dollars are awarded on a noncompetitive basis.² Although ready, willing, and able to perform government work at lower prices,

small businesses have been repeatedly discouraged by contracting officials who find it easier to deal with larger firms.³ Small businesses also find it difficult to deal with the paper work and other requirements peculiar to contracting with Uncle Sam.

To realize the strategic benefits of small business participation in the defense industrial base, the declared policy of Congress, as stated in the Small Business Act, is to "aid, counsel, assist, and protect . . . the interests of small business concerns" and "insure that a fair proportion of the total purchases and contracts or subcontracts . . . be placed with small business enterprises."⁴ To achieve this objective, certain advantages have been given to small businesses and to small businesses owned by disadvantaged persons in the procurement process. These benefits will be discussed in detail below, following a discussion of what a small business is.

What is a Small Business?

A "small business concern" is defined by the Small Business Act as "one which is inde-

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pendently owned and operated and which is not dominant in its field of operation."⁵ Implementing regulations promulgated by the Small Business Administration (SBA) establish size standards for various standard industrial classification codes.⁶ Revised size standards were issued by the SBA in 1984 to deal with the effects of inflation, among other things. The amended regulation, in a departure from prior SBA practice, provides a single set of size standards for both procurement and financial assistance programs.⁷ Size standards are stated either by average annual receipts or number of employees. Since size standards are on a standard industrial classification code basis, a company may be a small business for one type of contract but not another.⁸

Small business status cannot be achieved by merely spinning off parts of a large business organization.⁹ In determining size, a business is lumped together with its "affiliates." Under applicable regulations "concerns . . . are affiliates of each other when either directly or indirectly (1) one concern controls or has the power to control the other, or (2) a third party or parties controls or has the power to control both." The regulations further state that "[i]n determining . . . whether or not affiliation exists, consideration shall be given to all appropriate factors, including common ownership, common management, and contractual relationships."¹⁰ Other factors indicating affiliation are family relationship of ownership,¹¹ common facilities,¹² and common attorneys and accountants.¹³

Many small businesses are family owned. Often the sale or gift of part of a business to another family member will be proposed to remain within applicable small business size standards. SBA regulations provide, however, that members of the same family have an identity of interest and are treated as one person.¹⁴ If read literally, this rule would result in the affiliation of all businesses owned or controlled by members of the same family. The SBA Size Appeals Board has ruled, however, that family relationship alone does not establish affiliation. In *Size Appeal of Maintenance Engineers*,¹⁵ for example the board found two concerns unaffiliated where a father owned 100 percent of company A and his son, a former officer of company A, owned 83 percent of company B. The board emphasized that firms A and B had separate books and offices,

were in different lines of business, had no contractual relations, and were financially independent.

Small business prime contractors should be aware of SBA's "ostensible subcontractor" rule,¹⁶ which states that a small business may be deemed to be affiliated with a large business subcontractor for purposes of a procurement. A subcontracting relationship alone will not result in a finding of affiliation.¹⁷ The rule comes into play where the subcontract relationship is a sham and the ostensible subcontractor controls or has the power to control the small business "prime" contractor.¹⁸

Self-Certification

Small business status is initially established through self certification,¹⁹ generally by checking a box on the standard bid form which states that the bidder represents and certifies that it is a small business concern.²⁰ Absent a size protest, self-certification is generally accepted by the contracting officer. A false certification to obtain small business benefits, not made in good faith, is a criminal offense under the False Claims Act.²¹

Challenging Small Business Status—Size Protests

Interested parties may challenge the small business status of a bidder or offeror by submitting a size protest to the contracting officer. Size protests are informal and no special rules of pleading are required other than a brief description of the specific grounds for the protest. A protest alleging that X is affiliated with Y, which combined exceed applicable size standards, is sufficient. It is insufficient, however, to merely allege that a concern is not small or is affiliated with unspecified other concerns.²²

A protest of a formally advertised procurement must be filed with the contracting officer "prior to the close of business on the 5th day, exclusive of Saturdays, Sundays, and legal holidays, after bid or proposal opening."²³ The time period for protesting a negotiated procurement is the same, but is measured from the receipt of contracting officer notification of the identity of the apparent successful

offeror.²⁴ A protest will also be timely if made to the contracting officer by telephone within the five-day period and the contracting officer receives written confirmation postmarked not later than one day after the telephone protest.²⁵

A contracting officer may, at any time after bid opening, question the size status of any offeror by filing a protest with the SBA.²⁶ Thus, even if a protester is late, his protest may be considered for the instant procurement, if the contracting officer adopts the protest as his own. Protesters should not count on contracting officers adopting late protests as their own, however.

Protests must be forwarded by the contracting officer to the SBA regional office serving the locale of the protested concern.²⁷ If no decision is made by the SBA regional office within 10 days of the receipt of a protest, the contracting officer can presume that the protested concern is small and make an award.²⁸

Challenging Regional Office Size Determinations—The Size Appeal

In late 1983 the SBA issued new procedures for appealing regional office size determinations and the size standards used by contracting officers. The revised regulation, 13 C.F.R. § 121.11, abolishes the SBA Size Appeals Board and replaces it with a new SBA Office of Hearings and Appeals (OHA).²⁹ In a major departure from informal Size Appeals Board proceedings, the new regulation requires a formal adjudicative process with a decision based on the record and *ex parte* contacts prohibited.³⁰

To apply to a pending procurement, appeals from a SBA regional office size determination must be filed within five working days of their receipt.³¹ A contract award will not be disturbed, however, if made after the regional office size determination, but before a size appeal is made.³² The OHA will rule only on appeals filed within 30 days of a regional office size determination.³³ An appeal is deemed to have been filed on the date postmarked if mailed, or on the date received by the OHA if otherwise delivered.³⁴

Appeals are initiated by filing a Notice of Appeal with the OHA in duplicate.³⁵ This can be done by mailing a Notice of Appeal to the Office of Hearings and Appeals, Small Busi-

ness Administration, Washington, D.C. or hand delivering it to the Office of Hearings and Appeals at 2100 K Street, N.W. Washington, D.C., 20416.³⁶ Telegraphic Notice of Appeal are permitted but must be confirmed by the next day mailing of a written duplicate.³⁷ The Notice of Appeal is to include the following:³⁸

(1) Name, address, and telephone of the party filing the appeal, identifying the person to be contacted for service of correspondence, notices, orders, pleadings, requests for information pertaining to the appeal;

(2) The substance and date of the size determination or product or service classification from which the appeal is taken, identification of the concern whose size is being determined, or the SIC or SBA size standard being applied;

(3) If applicable, the invitation for proposal number and date, and the address, and telephone number of the contracting officer;

(4) A full and specific statement of reasons why the size determination or product or service classification appealed is allegedly erroneous;

(5) Presentation of arguments in support of such allegations; and

(6) A statement certifying that copies of the Notice of Appeal have been served on the following, where applicable:

- (i) The contracting officer;
- (ii) The Small Business Administration official whose determination is appealed;
- (iii) A protestant who is not the appellant;
- (iv) The Concern whose size status is in issue; and
- (v) Any other identifiable interested person.

The appeal as well as subsequent pleadings and other documents must be signed by an authorized person and contain a statement of verification.³⁹

"I have read this document and understand the legal consequences and the penalty of law and the sanctions imposed by 18 U.S.C. 1001, of which I am aware, and that, to the best of my knowledge, the statements made herein are true and correct."

that this document is not being filed for the purpose of delay or harassment."

More detailed guidance on OHA procedures can be found in SBA Regulations contained in 13 C.F.R., Part 121.11.

Challenging Solicitation Size Standards— Informal Protest to the Contracting Officer

There is often a question whether a solicitation for a small business set-aside includes the correct size standard. As noted above, small business size standards are established by standard industrial classification code (commonly referred to as SIC code), prepared and published by the Office of Management and Budget. The ultimate question is generally whether a solicitation contains the size standard for the correct SIC code.

The use of an improper SIC code can be detrimental to small business bidders. If too high a standard is used, as a result of using either the wrong SIC code or a clerical error, large businesses can compete for and be awarded contracts set aside for small business. Small business concerns should therefore be prepared to take timely action to assure that a proper size standard is used.

If there is sufficient time, it is advisable to first bring the perceived error to the contracting officer's attention. In many cases, a contracting officer will acknowledge the error, cancel or amend the defective solicitation, and resolicit using the correct size standard. It is important to leave enough time to submit a timely appeal to SBA if necessary.

Note that a contracting officer is not barred from amending a solicitation to correct an improper size standard just because the time for appealing to the SBA has elapsed. It is not good practice to count on this, however. Any oral communications or understandings reached with a contracting officer should be promptly confirmed in writing.

Challenging Solicitation Size Standards— The Size Protest

With the exception of applicable time limits, the procedure for appealing a solicitation size standard is the same as for appealing SBA

regional office size determinations. The time for appealing a size standard used in a solicitation depends upon how long it is open for bids. If bids or proposals are due more than 30 days after a solicitation is issued, an appeal must be filed not less than 10 working days before bids or proposals are due. If due less than 30 days after a solicitation is issued, an appeal must be filed not less than five working days before bids or proposals are due. In an apparent oversight, the new regulation does not state what time limit is applicable if bids or proposals are due exactly thirty days after a solicitation is issued.⁴⁰

Untimely appeals of size standards used in solicitations will be dismissed.⁴¹ The contracting officer would not be barred, however, from amending a solicitation to correct an improper size standard because the time for submitting an appeal has passed.⁴²

Small Business Advantages

Set-Aside Programs In General

Under set-aside programs, contracts are (at least theoretically) reserved exclusively for small business bidders. The purpose of set-aside programs is to maintain or mobilize our productive capacity for use in a national emergency and assure that a fair proportion of contracts are placed with small business concerns.⁴³

Set-aside programs are of three basic types. The first is the traditional set-aside under which contracts may be set aside for small business concerns if there is adequate small business competition.⁴⁴ The second is small business small purchase set-asides, established in 1978 under Public Law 95-507 amendments to the Small Business Act. These amendments reserve for small business concerns contracts that are under \$10,000 and subject to small purchase procedures, unless the contracting officer is unable to find two or more small business concerns capable of performing.⁴⁵ The third type is small business innovation research (SBIR) set-asides under Public Law 97-219.

Traditional Set-Asides

Procurement regulations provide that contracts, or a class of contracts, "shall" be set

aside for small business if the contracting officer determines that there is a reasonable expectation that 1) bids or proposals will be received from at least two small businesses offering the products of different small businesses and 2) an award will be made at a reasonable price.⁴⁶ The word "shall" appears to make set-asides mandatory if the required conditions are met. In practice, however, set-asides are highly discretionary with contracting officials.

Goods and services needed by the government are screened by the contracting officer and the SBA procurement center representative (PCR) assigned to the facility to determine if contracts for such requirements are suitable for small business set-asides. Set-asides may be unilaterally established by the contracting officer, or instituted by the contracting officer based on the recommendation of the SBA PCR.⁴⁷

A contracting officer will sometimes split (or otherwise restructure) a requirement to encourage participation by the two or more small business offerors needed for a set-aside. The SBA PCR is in a strategic position to help obtain set-asides since he is privy to planned procurements before they are announced to the public.⁴⁸

Although the recommendation of the SBA PCR is not binding on the contracting officer, if given adequate factual support he will generally be a powerful advocate for a set-aside. If a contracting officer rejects a SBA PCR's set-aside recommendation, the PCR may appeal the rejection to the head of the contracting activity.⁴⁹ If the appeal is denied, the SBA may appeal to the head of the agency and within one business day request that the contracting officer suspend action until an appeal to the agency head is filed.⁵⁰ The contracting officer must honor this request unless he determines that making an award is in the public interest and provides a written statement of facts supporting his determination for the contract file.⁵¹

Unlike small business/small purchase set-asides (discussed below), to be eligible for the award of a traditional set-aside for manufactured items, a firm is required to be either a small business manufacturer of the end item or a small business dealer providing the product of a small business manufacturer.⁵² To be deemed a manufacturer, a firm must make a significant contribution to the production of

the required end item. In determining whether this standard has been met, the SBA looks at both the value to be added and type of work to be done by the prime contractor.⁵³

The determination of whether a firm qualifies as a manufacturer is more dependent upon what it proposes to do as opposed to its percentage contribution. A low percentage of total cost is generally found to constitute manufacturing where assembly operations are involved and the firm performs production-related functions such as quality control. For example, in *Size Appeal of Fire-Tec*,⁵⁴ a firm was found to be a manufacturer although its percentage contribution was only 16.7 percent it assembled a fire truck from components manufactured by large firms. As stated by the Size Appeals Board at p. 8:

"The size regulation refers to the 'end item being procured' and Board precedents have construed the term 'manufacturer' in relation to the item being procured. However, there has been no absolute percentage established as to the value of various components and portions of the work. In some cases the Board has accepted low percentages of total cost as constituting significant manufacturing when fabrication or assembly operations were involved and the firm coordinated suppliers and performed necessary functions closely related to the production process, such as testing and inspection of the final product. The Board finds that G has full responsibility for the end item which is the fire truck."

Irrespective of a contractor's percentage contribution, it will not qualify as a manufacturer if its efforts are limited to subdividing and packaging the end product. For example in *Size Appeal of Platt & Son, Inc.*,⁵⁵ it was held that although a firm's contribution consisted of 51 percent of the contract price, it did not qualify as a manufacturer of wire rope where it would just cut, lubricate, seize the ends of, coil, build boxes for, and ship the end product.

Small Business-Small Purchase Set-Asides

Public Law 95-507, enacted in 1978, established a new type of set-aside for contracts under \$10,000.⁵⁶ More specifically, it added

section 15(j) to the Small Business Act,⁵⁷ which provides as follows:

"Each contract for the procurement of goods and services which has an anticipated value of less than \$10,000 shall be reserved exclusively for small business concerns unless the contracting officer is unable to obtain offers from two or more small business concerns that are competitive with market prices and in terms of quality and delivery of the goods or services being purchased. In utilizing small purchase procedures, contracting officers shall, whenever circumstances permit, choose a method of payment which minimizes paperwork and facilitates prompt payment to contractors."

Based on the language enacted by Congress, small business/small purchase set-asides appear superior to the standard set-asides in several respects. To begin, there is a statutory presumption that these contracts are suitable for a set-aside. To establish a standard set-aside, it must be affirmatively demonstrated that there are two or more small businesses willing to bid. Under small business/small purchase set-asides, a requirement is set aside unless the contracting officer is unable to find two or more small business bidders. To the further advantage of small businesses, these set-asides use simplified small purchase procedures and provide for expedited payment. Unfortunately for the small business community, as often is the case, appearance belies reality.

The rule that a contract must be set aside unless the contracting officer is unable to find at least two small business bidders has led contracting officers to overlook small businesses ready, willing, and able to bid. Contracts for aircraft spare parts are a prime example. These contracts are repeatedly awarded to the same large firms on a noncompetitive basis, with the actual work often performed by small business subcontractors with whom the armed services choose not to contract directly.

A recently promulgated regulation, aimed at fostering spare parts competition, exempts contracts with an annual buy value of under \$10,000 from screening for new sources.⁵⁸ This rule perpetuates the sole-source award of such contracts to members of the Fortune 500.

The implementation of small business/small purchase set-asides has also been criticized by small manufacturers. Unlike traditional set-asides which require that a product of a small business be furnished, a small business dealer may offer the product of a large business in a small business/small purchase set-aside.⁵⁹

If a small business desires to compete for small business/small purchase set-asides, it should regularly review that bid board at the procuring activity or subscribe to a service that performs this function. Under small purchase procedures solicitation is generally limited to three sources.⁶⁰ Unless they regularly review the bid boards, small businesses not solicited will probably never hear of the opportunity since under \$10,000 requirements are not required to be synopsized in the *Commerce Business Daily*.⁶¹

Small Business Innovation Research Set-Asides

To increase the government's use of the innovative capabilities of small businesses, the Small Business Innovation Development Act, Pub. L. 97-219, was enacted in 1982. Under the Small Business Innovation Development Act, federal agencies with annual "extramural" research and development (R&D) budgets in excess of \$100,000,000 are required to set aside a portion of their R&D budget for award under Small Business Innovation Research (SBIR) programs.⁶² "Extramural budget" is the total R&D budget less the amount to be spent on R&D performed by agency employees or through government-owned, government-operated facilities.⁶³

The portion of agency extramural R&D budgets to be set aside for award under SBIR programs is to be incrementally phased in. For nondefense agencies, the portion required to be set aside is respectively 0.2 percent, 0.6 percent, and 1.0 percent for FYs 83, 84, and 85, and 1.25 percent per fiscal year thereafter. For the Department of Defense, the portion required to be awarded is respectively 0.1 percent, 0.3 percent, 0.5 percent, and 1.0 percent for FYs 83, 84, 85, and 86, and 1.25 percent per fiscal year thereafter.⁶⁴

The purpose of the SBIR program is to revitalize the economy by developing "a means by which Federal agencies can better tap the

innovative potential of small businesses."⁶⁵ The need for the legislation was stated in the Senate Report:⁶⁶

"Numerous studies have shown that small businesses are our Nation's most efficient and fertile source of innovations. Yet only 3.5 to 4 percent of the Federal R. & D. dollar is spent with small firms. This underutilization of small businesses in Federal R. & D. programs is especially regrettable when considering the highly successful track record of small firms in generating jobs, tax revenues, and other economic and societal benefits.

"According to the Office of Federal Procurement Policy, between 1953 and 1973, firms with fewer than 1,000 employees accounted for approximately one-half of the major U.S. innovations. Moreover, these firms had a ratio of innovations to R. & D. employment which was four times greater than that found in larger firms and a total cost per R. & D. scientist or engineer which was about one-half that found in firms of over 1,000 employees.

"Similarly, a National Science Foundation survey of major innovations introduced into the market between 1953 and 1973 found that small firms produced about 24 times as many innovations per R. & D. dollar as large firms and 4 times as many as medium sized firms.

"Studies also show the important role of small innovative businesses in creating jobs and stimulating economic growth. David Birch of MIT found that firms with 500 or less employees provided 87 percent of all new jobs in the United States between 1969 and 1976. He also found that the best job creator was the small high technology-based firm.

* * *

"Since the economic rewards of R. & D. conducted by small companies are so obvious, it is disturbing that so much of our research is concentrated in the larger firms. . . ."

The act requires SBA to issue policy directives for the general conduct of agency SBIR programs.⁶⁷ The most recent SBA Policy Directive on the SBIR program was issued in September 1984.⁶⁸ To qualify for a SBIR award, a firm must be a small business under applicable size standards.⁶⁹ It must also be the primary source of the employment of the principal investigator of the proposed R&D at award

and during contract performance. In addition, at least two-thirds of the work must be carried out by the proposing firm in Phase I of the three-phase SBIR program and one-half in Phase II of the program.⁷⁰

In Phase I, the agency solicits proposals to determine the technical feasibility of a proposed R&D effort. The implementing SBA directive states: "The object of this phase is to determine the technical feasibility of the proposed effort and the quality of performance of the small firm with a relatively small agency investment."⁷¹ Phase I performance normally will not exceed six months.⁷² Although there is no dollar limit on Phase I awards, a large number of awards of up to \$50,000 are anticipated.⁷³

At least annually, agencies are required to issue Phase I SBIR solicitations on "a substantial number of research or R&D topic and subtopic areas consistent with stated agency needs or missions."⁷⁴ In addition, the SBA is required to issue Master Phase I Program Solicitation release schedules covering the SBIR program of all participating agencies.⁷⁵ The SBA master schedule must be sufficiently detailed "to effectively apprise appropriate segments of the Nation's small business community of forthcoming SBIR Program Solicitations."⁷⁶

Phase II is the principal R&D effort. An agency decision to fund a Phase II effort is based upon the results of scientific and technical merit of the R&D effort as demonstrated by Phase I results and the Phase II proposal.⁷⁷ The duration of Phase II performance will normally not exceed two years.⁷⁸ Although there is no dollar limit on Phase II awards, most should be \$500,000 or less.⁷⁹

Phase III involves pursuit of commercial applications of research funded in Phases I and II, using nonfederal funds. Under Phase III agencies may award non-SBIR funded R&D or production contracts for potential products of use to the government.⁸⁰

The act requires that the SBA, in implementing directives, provide for "retention of rights in data generated in the performance of the contract by the small business concern."⁸¹ Accordingly, the SBA policy directive recommends that agencies protect technical data generated in contract performance for two years unless permission to disclose is obtained from the contractor.⁸²

The recommended two-year protection period gives small business contractors a reasonable opportunity to obtain patent protection. After the two-year period, the government retains a royalty-free license for use of any data delivered under the SBIR funding agreement.⁸³ A contractor who has obtained a patent has a right to commercial exploitation. The SBIR approach to data generated during contract performance is consistent with the federal government's patent policy for small business concerns as set forth in Public Law 96-517.⁸⁴

Certificate of Competency

For a firm to be awarded a government contract, a determination must be made that it is responsible (i.e., capable of performing).⁸⁵ To be determined responsible, a prospective contractor must meet the general standards set forth in FAR 9.104-1.

Generally, the contracting officer has the final determination as to a firm's responsibility.⁸⁶ However, small businesses may request review by the SBA of a contracting officer's negative responsibility determination. The SBA is also given the final authority, under the Small Business Act § 8(b)(7),⁸⁷ to determine whether a small business is a "manufacturer" or "regular dealer" eligible for contract award under the Walsh-Healy Public Contracts Act, 41 U.S.C. § 35(a). The review contemplated is conducted under SBA's certificate of competency program.

The certificate of competency legislation was a result of the systematic exclusion of small business from defense contracts during World War II. Testimony in 1942 hearings before the Senate Banking and Currency Committee showed that contracting officers often refused to make awards to small business concerns on grounds that they were not responsible, while the same "nonresponsible" small business concerns were performing the work as subcontractors to "responsible" large firms. The War Production Board also called for the enactment of legislation to correct the tendency of contracting officers to underestimate the capabilities of small firms and the resulting negative impact on the war effort.⁸⁸

Under the certificate of competency program, a contracting officer must refer a small

business negative responsibility determination to the SBA for review.⁸⁹ Referral is also required if a contracting officer finds that a small business may not qualify as a manufacturer or regular dealer eligible for the award of a supply contract.⁹⁰

The certificate of competency (COC) program has saved the federal government large sums by mandating award to a low bidder who otherwise would not have received an award. According to the SBA, \$16.8 million was saved as a result of \$230 million in contracts awarded to small businesses as a result of the COC program in FY 83.⁹¹ These savings have not been achieved at the expense of contractor performance. In FY 83 less than five percent of all COC recipients failed to perform their contracts.⁹²

Recent controversy has focused on the use of bidder prequalification by contracting officials to avoid the certificate of competency process. Under bidder prequalification, a business is required to demonstrate its capability to perform before submitting a bid or proposal. Procuring agencies have taken the position that a small business is entitled to certificate of competency review only if it would have been awarded a contract except for a contracting officer's negative responsibility determination. If a small business is precluded from bidding, this stage in the procurement process is never reached.

A governmentwide system of bidder prequalification for audiovisual and videotape procurements was reviewed by the General Accounting Office (GAO) in *Office of Federal Procurement Policy's Films Production Contracting System*.⁹³ The GAO held that determinations that small businesses are not qualified to bid must be referred to the SBA for a final responsibility determination under the certificate of competency program. Nevertheless, the SBA refused to review these negative capability determinations, saying that it had no statutory authority unless a small business was in line for a particular contract award.⁹⁴ As a result of the recently enacted Small Business and Federal Competition Enhancement Procurement Act of 1984, however, the SBA now must accept all certificate of competency referrals.⁹⁵

In 1982 the SBA (without notice and comment) amended its regulations to make referral discretionary with the contracting agency,

where the contract amount is less than \$10,000.⁹⁶ This exemption was widely criticized in the small business community. An example is the September 16, 1982, statement of the National Tooling and Machining Association to the Senate Committee on Small Business.⁹⁷

"In an apparent attempt to sidestep the requirements of the Regulatory Flexibility Act, SBA claimed that the rule had no impact on small business. This is utterly preposterous. Perhaps the most important impact of the COC program is not the COCs actually awarded, but the fact that it deters contracting officers from issuing baseless non-responsibility determinations. They know that if they issue a baseless determination, it will be reversed by SBA. As you know, Public Law 95-507 reserves under \$10,000 contracts for small business bidders. The result of this rule-making brainstorm by the supposed protector of small business will likely be that contracting officers will steer such contracts to large business concerns on grounds that there are not two responsible small business bidders. We believe that SBA owes the Committee some answers on this curious rulemaking effort that both substantively and procedurally frustrates its legislative mandate."

As previously stated, the SBA is now precluded by the recently enacted Small Business and Federal Procurement Competition Enhancement Act of 1984 from establishing exemptions from referral.⁹⁸

Access to Bid Sets and Specifications

Although small businesses have often located agency requirements in the *Commerce Business Daily*, their requests for solicitations have often been refused, because the agency's supply was exhausted. To ameliorate this barrier to small business participation, Congress enacted 15 U.S.C. § 637b as part of Public Law 95-507.⁹⁹ That statute requires agencies to give small businesses upon request "a copy of bid sets and specifications."

Contracting officials generally comply with this requirement if it is called to their attention. The GAO has held, however, that the statute is not violated as long as there is ade-

quate competition and no deliberate attempt to exclude a firm.¹⁰⁰ The GAO has also held that agencies can charge a small user fee to cover the cost of providing requested documents.¹⁰¹

Subcontracting

Many small businesses prefer to sell to the government indirectly as subcontractors to avoid the bureaucratic entanglement involved in federal prime contracting.

In the Small Business Act, Congress stated that a fair proportion of the federal government's total purchases will be placed with small business concerns through "contracts or subcontracts." (Emphasis added.)¹⁰² To encourage small business subcontracting, Congress, in enacting Public Law 95-507, required contractors selected for award of large contracts to submit subcontracting plans.¹⁰³

Subcontracting plans are required to include percentage subcontracting goals for small businesses in general and small businesses owned and controlled by socially and economically disadvantaged individuals. The plans are also required to describe the efforts that will be taken to meet these goals.¹⁰⁴ Furthermore, the procuring agency must determine that the plan provides maximum practicable opportunity for subcontracting to small businesses and small businesses owned and operated by socially and economically disadvantaged individuals. The failure of a contractor to comply with a subcontracting plan is a "breach of contract" justifying a termination for default.¹⁰⁵ Despite numerous cases of non-compliance, however, this drastic remedy is apparently not being used.

For subcontracting assistance, information on subcontracting opportunities can be obtained from SBA field offices. Subcontracting opportunities can also be identified in the *Commerce Business Daily* listings of prime contract awards.

A potential subcontractor should realize that subcontracts are commercial rather than government contracts. Unlike the government, which is required to deal with potential sources on an impartial basis, a prime contractor can generally deal with whomever it wants. Therefore, a potential subcontractor should

use the same marketing techniques used with its other commercial accounts.

Special Advantages for Minority-Owned Small Businesses

The 8(a) Program

Section 8(a) of the Small Business Act provides the statutory basis for the SBA's Minority Small Business and Capital Ownership Development Program—the 8(a) program.¹⁰⁶ Its purpose is to "foster business ownership by individuals who are both socially and economically disadvantaged" and to "promote the competitive viability of such firms by providing such available contract, financial, technical, and management assistance as may be necessary."¹⁰⁷ The program is premised on the congressional finding that to obtain social and economic equality and improve the functioning of our economy, special attention should be given to the development of small businesses owned by disadvantaged individual.¹⁰⁸

To be admitted to the 8(a) program, as discussed below, a firm must be owned and operated by "socially and economically disadvantaged individuals" and have a reasonable prospect of success. The substantial economic benefits available to disadvantaged firms include the award of federal contracts on a sole-source basis, interest-free loans in the form of advance payments, and the outright gift of government funds known as business development expense (BDE).

Because of the few firms graduating from the program, Congress in Pub. L. 96-481 required fixed program participation terms (FPPTs) for all 8(a) firms. Implementing regulations set the maximum FPPT at five years, plus a possible extension for up to two years.¹⁰⁹ These aspects of the 8(a) program will now be addressed.

Eligibility Requirements

To be admitted to the 8(a) program, a firm must meet three statutory eligibility requirements. It must be 1) a small business, 2) controlled and operated by "socially and economically disadvantaged individuals," and 3) have

a reasonable prospect for success in the private sector.¹¹⁰

Note that an applicant must qualify as a small business concern under applicable SBA rules. A successful applicant must also demonstrate that it is at least 51 percent owned by and that its daily business operations are controlled by, one or more "socially and economically disadvantaged individuals."¹¹¹

Socially disadvantaged individuals are "those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as members of a group without regard to their individual qualities."¹¹² In the absence of evidence to the contrary, members of certain groups are presumed to be socially disadvantaged. These include black and Hispanic Americans, as well as native Americans and Asian Pacific Americans.¹¹³ This presumption may be rebutted in individual cases.¹¹⁴

If an 8(a) applicant falls within one of the minority groups presumed to be socially disadvantaged, he need only demonstrate his economic disadvantage.¹¹⁵ Individuals who are not members of one of the groups must demonstrate their social disadvantage with clear and convincing evidence. This requires the following showing:¹¹⁶

"(A) The individual's social disadvantage must stem from his or her color; national origin; gender; physical handicap; long-term resident in an environment isolated from the mainstream of American society; or other similar cause not common to small business persons who are not socially disadvantaged.

"(B) The individual must demonstrate that he or she has personally suffered social disadvantage, not merely claim membership in a non-designated group which could be considered socially disadvantaged.

"(C) The individual's social disadvantage must be rooted in treatment which he or she has experienced in American society, not in other countries.

"(D) The individual's social disadvantage must be chronic, long-standing, and substantial, not fleeting or insignificant.

"(E) The individual's social disadvantage must have negatively impacted on his or her entry into, and/or advancement in, the business world. SBA will entertain any relevant evidence in assessing this element of an appli-

cant's case. SBA will particularly consider and place emphasis on the following experiences of the individual, where relevant: Education, employment, and business history. . . ."

Economically disadvantaged individuals are "those socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished credit and capital opportunities as compared to others in the same business area who are not socially disadvantaged." SBA considers the assets and net worth of a socially and economically disadvantaged individual in making its economic disadvantage determination.¹¹⁷

An otherwise eligible small business must demonstrate "that with contract, financial, technical, and management support the small business will be able to perform contracts which may be awarded to such concern . . . and has reasonable prospects for success in competing in the private sector."¹¹⁸ The SBA considers, in addition to the firm's potential, the finite SBA resources for assisting 8(a) firms.¹¹⁹ Thus a promising construction firm could be denied entry because not enough construction opportunities are available.

The "Catch-22" of obtaining entry to the program is demonstrating *both* economic disadvantage and a reasonable prospect for success. Stated otherwise, to obtain program entry an applicant must simultaneously demonstrate that it is economically disadvantaged, but not *too* economically disadvantaged.

Contract Support

The SBA's function includes locating, obtaining, and matching federal procuring agency requirements with firms admitted to the 8(a) program. It also includes the evaluation of contract opportunities offered directly to the SBA by procuring activities and marketed by 8(a) concerns. Applicable procedures are set forth in the SBA Standard Operating Procedure (SOP) titled "Minority Small Business and Capital Ownership Development."¹²⁰ Unlike a regulation, however, the SOP is not binding on SBA officials.¹²¹

A federal contract placed in the program is first awarded without competition to the SBA. It is then subcontracted (again without com-

petition) to an 8(a) firm.¹²² This two tier approach is used because most disadvantaged firms are small businesses. As intended by Congress,¹²³ however, 8(a) concerns bear the brunt of negotiating the contracts and dealing with the procuring agency during contract performance. In fact, it has been held that this scheme results in privity of contract between the procuring agency and the 8(a) subcontractor.¹²⁴

The 8(a) program has been unpopular with nondisadvantaged small firms because of its noncompetitive basis. The 8(a) program is not intended, however, to deprive nonparticipating small businesses of contracting opportunities. Before a requirement is selected for the program, SOP 80-05 requires a statement of the impact on non-8(a) small businesses.¹²⁵ If a requirement was previously a small business set-aside, or if small businesses have relied on it, it should not be withdrawn for the 8(a) program.¹²⁶

Advance Payments

Advance payments are interest free loans available to a concern awarded a contract under the 8(a) program. They are intended to finance contract performance. Advance payments are liquidated from the proceeds derived from the performance of the contract. Payments for work as completed are deposited directly by the procuring agency in a special bank account used to liquidate advance payments.¹²⁷

The SBA's routine award of advance payments to 8(a) concerns drew wide criticism in the late 1970s. Federal investigators discovered that these interest-free loans were being used for purposes other than financing contract performance. In one highly celebrated case they were allegedly used to purchase a racehorse.¹²⁸

Business Development Expense

Business development expense (BDE) is an outright gift of SBA funds to an 8(a) concern to facilitate 8(a) contract performance.¹²⁹ The philosophy behind the use of BDE, with proper safeguards, is stated in the SBA Standard Operating Procedure.¹³⁰

to make awards to the large firms on a non-competitive basis. It is to be hoped that the recent revelations that the armed services pay

\$750 for a pair of pliers, \$1,100 for plastic stool caps, and \$9,600 for simple hexagonal wrenches will lead to a move in that direction.

Footnotes

1. Source: Federal Procurement Data Center, Standard Report, April 1, 1984, and Special Report 1226A, July 26, 1984.
2. 56.3 percent or \$75.1 billion of the \$133 billion in contracts placed by DoD in FY 84 were awarded noncompetitively. *Federal Procurement Data System Standard Report Fiscal Year 1984 Fourth Quarter*, p. 25 (1985).
3. See Seidman, "How to Save A Few Billion Dollars: Defense Bureaucrats Could Save That Much by Contracting With Smaller Companies." *Inc.*, 12 (February 1982).
4. Small Business Act, Section 2(a), 15 U.S.C. §631(a).
5. 15 U.S.C. §632(a).
6. 13 C.F.R. §121.2 (1985).
7. 49 *Federal Register* 5024, February 9, 1984.
8. *Standard Industrial Classification Manual* (1972) and 1977 Supplement, prepared by Statistical Policy Office, Office of Management and Budget.
9. See 13 C.F.R. §121.3(a)(vi)(C).
10. 13 C.F.R. §121.3(a).
11. 13 C.F.R. §121.3(a)(ii).
12. 13 C.F.R. §121.3(a)(vi)(B).
13. Size Appeal of Propper International Inc., Size Appeal #769 (July 24, 1975).
14. 13 C.F.R. §121.3(a)(ii).
15. Size Appeal #770 (July 30, 1975). To the same effect: In the Matter of Kasper Brothers, Size Appeal #1252 (April 9, 1979); Size Appeal of Eastern Trans-Waste Corp., Size Appeal #1569 (July 13, 1982).
16. 13 C.F.R. §121.3(a)(vii)(C).
17. Size Appeal #1728, (1983).
18. Integrated Systems Analysts, Inc., Size Appeal #1923, (April 11, 1984).
19. 13 C.F.R. §121.5(a).
20. See FAR §52.219-1.
21. 18 U.S.C. §287. See also 31 U.S.C. §§3729-3730 (1983).
22. 13 C.F.R. §121.9(a); see Size Appeal of Fennell Container Co. Size Appeal #2080 (November 23, 1984).
23. 13 C.F.R. §121.9(a).
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. FAR §19.302(h)(1).
29. 48 *Federal Register* 55832, December 16, 1983.
30. *Id.*
31. 13 C.F.R. §121.11(e)(2).
32. Size Appeal of Fordice Construction Co., No. 1926, April 13, 1984. *Contra* Wilkinson & Jenkins v. Army Corps of Engineers, No. 85-205-Civ-J-16 (M.D. Fla. April 4, 1985) discussed at 43 BNA *Federal Contracts Report* 744, April 29, 1985.
33. 13 C.F.R. §121.11(e)(2).
34. 13 C.F.R. §121.11(d).
35. 13 C.F.R. §121.11(f).
36. 13 C.F.R. §121.11(d).
37. 13 C.F.R. §121.11(f).
38. *Id.*
39. 13 C.F.R. §121.11(n)(3).
40. 13 C.F.R. §121.11(e)(3).
41. *Id.*
42. See Pacer Systems, Inc., B-215999, 84-2 CPD ¶645 (1984).
43. 15 U.S.C. §644(a), FAR §19.502-1.
44. 15 U.S.C. §644, FAR §19.502-2.
45. 15 U.S.C. §644(j).
46. FAR §19.502-2.
47. FAR §19.501(b).
48. FAR §19.402(b).
49. FAR §19.505(b).

50. FAR §19.505(c).
51. FAR §19.505(f).
52. 13 C.F.R. §§121.5(b)(1) and (2).
53. Size Appeal of Michigan Instruments Corporation, No. 2012, August 23, 1984.
54. No. 1262, June 1, 1979.
55. No. 1946, May 8, 1984.
56. Pub. L. 95-507, §221.
57. 15 U.S.C. §644(j).
58. DOD FAR Supplement, Supplement No. 6, §S6-201.2(k).
59. FAR §19.501(f)(2).
60. FAR §13.106(b)(5).
61. 15 U.S.C. §637(e).
62. 15 U.S.C. §638(f)(1).
63. 15 U.S.C. §638(e)(1).
64. 15 U.S.C. §638(f)(1).
65. S. Rep. No. 97-194, 97th Cong., 1st Sess. 6 (1984).
66. *Id.* at 4-5.
67. 15 U.S.C. §638(j).
68. SBA Policy Directive on the Small Business Innovation Development Act, SOP 65 01.2 (September 84).
69. *Id.* at para. 4.g.
70. *Id.* at para. 6.c.
71. *Id.* at para. 6.d(1).
72. *Id.* at para. 12.j.(1).
73. *Id.* at para. 12.k.(1).
74. *Id.* at para. 6.b.
75. *Id.* at para. 10.a.
76. *Id.* at para. 10.b.
77. *Id.* at para. 6.d.(2).
78. *Id.* at para. 12.j.(2).
79. *Id.* at para. 12.k.(1).
80. *Id.* at para. 6.d.(3).
81. 15 U.S.C. §638(j)(2)(E).
82. SBA Policy Directive No. 65 01.2, para. 12.e.
83. *Id.*
84. 35 U.S.C. §§200-211; OMB Bulletin 81-22, 46 *Fed. Reg.* 34775 (1981). For a good discussion of the Pub. L. 96-517, Patent Policy for Small Businesses and Nonprofit Organizations, see R. Nash & L. Rawicz, *Patents and Technical Data*, 145-161 (1983).
85. 10 U.S.C. §§2305(b)(3), 2305(b)(4)(D); 41 U.S.C. §253b. FAR §9.103(b).
86. FAR §9.105-2(a)(1.)
87. 15 U.S.C. §637(b)(7).
88. *Senate Hearings on S. 2250*, 77th Cong., 2nd Sess.
89. 15 U.S.C. §637(b)(7)(A).
90. 15 U.S.C. §637(b)(7)(B).
91. U.S. Small Business Administration, *The State of Small Business: A Report to the President*, March 1984, p. 329.
92. *Id.* at n.22.
93. 60 Comp. Gen. 104, 80-2 CPD ¶419 (1980).
94. Letter from Bernard Kulik, associate administrator, for Procurement Assistance, SBA, to Michael J. Boyle, senior attorney, GAO (Mar. 20, 1981).
95. Pub. L. 98-577, §401, 15 U.S.C. §637(b)(7)(C).
96. 47 *Federal Register* 34972, August 12, 1982.
97. *To Consider S. 2446 and Other Small Business Procurement Reforms*; Hearings Before the Senate Committee on Small Business, 97th Cong., 2nd Sess., 23, 36 (1982), (Statement of Bruce N. Holn, manager, Government Affairs).
98. Pub. L. 98-577, 15 U.S.C. §637(b)(7)(C).
99. Pub. L. 95-507, §223(a).
100. *Lavelle Aircraft Company*, B-211479, 83-2 CPD ¶160, affirmed 83-2 CPD ¶300 (1983).
101. *W.B. Jolley*, B-209933, 83-1 CPD ¶609 (1983).
102. 15 U.S.C. §631(a).
103. 15 U.S.C. §637(d).
104. *Id.*
105. *Id.*
106. 15 U.S.C. §637(a).

107. 15 U.S.C. §631(e)(2).
108. 15 U.S.C. 631(e)(1).
109. Pub. L. 96-481, codified at 15 U.S.C. §636(j)(10)(A)(i); 13 C.F.R. §124.1-1(f)(4).
110. 15 U.S.C. §§637(a)(4)-(7).
111. 15 U.S.C. §637(a)(4).
112. 15 U.S.C. 637(a)(5).
113. 15 U.S.C. §631(e)(1).
114. 13 C.F.R. §124.1-1(c)(3)(ii).
115. *Id.*
116. 13 C.F.R. §124.1-1(c)(3)(iii).
117. 15 U.S.C. §637(a)(6).
118. 15 U.S.C. §637(a)(7).
119. 13 C.F.R. §124.1-1(c)(4)(ii).
120. *SBA Standard Operating Procedure (SOP) 80-05*, Chapter 7.
121. Rowe Contracting Service, Inc., B-203542, 81-2 CPD ¶92 (1981).
122. 15 U.S.C. §637(a)(1).
123. 15 U.S.C. §637(a)(3).
124. R & R Construction Co., VACAB No. 1101, 74-2 BCA ¶10857 (1974).
125. SOP 80-05, para. 52.e., and Appendix 3.
126. *Id.*
127. 13 C.F.R. §124.1-2.
128. Smith, *Millions in U.S. Loans Squandered in Minority Program, Inquiry Finds*, N.Y. Times, Nov. 9, 1979, p.1.
129. 13 C.F.R. §124.1-4(a).
130. SOP 80-05, para. 94.
131. 13 C.F.R. §124.1-4(a)(1).
132. SOP 80-5, para. 97.
133. 13 C.F.R. §124.1-4(a)(2).
134. 13 C.F.R. §124.1-4(b).
135. SOP 80-05, para. 97.
136. Pub. L. No. 96-481, codified at 15 U.S.C. §636(j)(10)(A)(i); 13 C.F.R. §124.1-1(f)(4).
137. 13 C.F.R. §124.1-1(f)(1).
138. 13 C.F.R. §124.1-1(f)(4).
139. 13 C.F.R. §124.1-1(f)(3)(iii).
140. 13 C.F.R. §124.1-1(d).
141. 13 C.F.R. §124.1-1(e).
142. 15 U.S.C. §637(a)(9).
143. 13 C.F.R. §124.10 et seq.