

# **ATTACHMENT 6**



2003-2004

**CHAIR**

Hubert E. Bell, Jr.  
Ste. 2600 Harris Tower  
233 Peachtree St. NE  
Atlanta, GA 30303-1530  
(404) 582-8027

**CHAIR-ELECT**

Patricia H. Wolfe  
Ste. 1100 East Tower  
1101 K St. NW  
Washington, DC 20005-3171  
(202) 414-9210

**VICE-CHAIR**

Robert J. Schacter  
12333 W. Olympic Blvd.  
Los Angeles, CA 90064-1021  
(310) 893-1609

**SECRETARY**

Michael A. Boddell  
Hannan Square 6th Flr  
600 14th St. NW  
Washington, DC 20004-2004  
(202) 220-1242

**BUDGET AND FINANCE OFFICER**

Patricia A. McLaughlin  
311 California St., 10th Flr  
San Francisco, CA 94104-2695  
(415) 956-2828

**SECTION DELEGATE AND IMMEDIATE PAST CHAIR**

Mary Ellen Coster Williams  
717 Marlison Pl. NW, Ste. 612  
Washington, DC 20005-1086  
(202) 219-9574

**PREVIOUS PAST CHAIR**

Norman R. Thorpe  
498 Abbey Rd  
Birmingham, AL 38009-5618  
(205) 644-8105

**COUNCIL MEMBERS**

Peter D. Balch  
PO Box 1027, MS 108-108  
Moorestown, NJ 08057-0927

Ross W. Bransetter, III  
7100 Defense Pentagon  
Washington, DC 20301-7100

Alexander J. Brittin  
1900 K St. NW, Ste. 100  
Washington, DC 20006-1108

Robert A. Burton  
725 12th St. NW, Rm 9013  
Washington, DC 20501

Mark D. Colley  
399 Pennsylvania Ave., NW, Ste. 100  
Washington, DC 20006-6800

John Alton Currier  
1601 Research Blvd  
Rockville, MD 20850-3171

Helaine G. Hiekerin  
6170 Fairview Park Dr., AEC 201A  
Falls Church, VA 22042-4516

Daniel I. Gordon  
1517 1 St. NW  
Washington, DC 20009-3909

Thomas E. Hill  
1100 Bk of Amer Plz, 901 Main St  
Dallas, TX 75201-3789

Karen L. Manos  
1299 Pennsylvania Ave., NW, 5th Flr  
Washington, DC 20004-2400

John E. Puchk, Jr.  
375 7th St. NW  
Washington, DC 20004

Donna Lee Yesner  
1900 K St. NW, Ste. 100  
Washington, DC 20006-1108

**EDITOR, PUBLIC CONTRACT LAW JOURNAL**

Carl E. Macketta  
Washington, DC

**EDITOR, THE PROCUREMENT LAWYER**

Mark F. Langewin  
Los Angeles, CA

**BOARD OF GOVERNORS LIAISON**

Barbara J. Roberts  
Columbia, SC

**SECTION DIRECTOR**

Marilyn Nemoras  
750 N Lake Shore Dr  
Chicago, IL 60611  
(312) 988-5506  
Fax: (312) 988-5688

Smith, Currie & Hancock LLP  
Suite 2600 Harris Tower  
233 Peachtree Street, NE  
Atlanta, GA 30303-1530  
Phone: (404) 582-8027  
Fax: (404) 688-0671

May 17, 2004

**Via E-Mail and Facsimile**

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
U.S. Small Business Administration  
409 Third Street, SW  
Mail Code 6530  
Washington DC 20416

**Re: Proposed Rule: Small Business Size Standards;  
Restructuring of Size Standards  
69 Fed. Reg. 13130 (March 19, 2004)**

Dear Mr. Jackson:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter.<sup>1</sup> The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees have members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

<sup>1</sup> Daniel I. Gordon, a Council member of the Public Contract Law Section, did not participate in the Section's consideration of these comments, and he abstained from the voting to approve this letter.

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 2

The Section has several concerns about the proposed rule. Most notably, as the Small Business Administration (“SBA”) has acknowledged, the proposed rule would render ineligible for SBA programs tens of thousands of currently eligible small businesses, which could cause a major adverse impact on these businesses. Second, the Section must, in fairness, question whether SBA has accurately assessed the full impact on the nation’s approximately 22.9 million small businesses. Moreover, the Section questions the SBA’s assessment that the conversion from receipts-based standards to employee-based standards will significantly simplify the size determination process. Finally, the proposed rule would have several significant negative collateral affects on small businesses. For these reasons, the Section requests that SBA withdraw the proposed rule or, at a minimum, adopt the modifications discussed below to mitigate the harm that would be caused to those currently eligible small businesses that would be adversely impacted by the passage of the proposed rule.

**I. The Government’s Purpose Does Not Appear To Outweigh The Harm That Would Be Suffered By Many Currently Eligible Small Businesses**

**A. The Proposed Rule Would Cause Thousands Of Companies To Lose Their Eligibility**

First, even by SBA’s own calculations, the proposed rule would cause thousands of small businesses to lose their small business size status. The significance of this critical fact cannot be overemphasized.

SBA acknowledges that “[t]he current structure of SBA’s size standards has worked well.” 69 Fed. Reg. at 13130. SBA nevertheless seeks to restructure and “simplify” its size standards by converting current annual receipts-based standards to new employee-based standards. SBA acknowledges that “if finalized . . . 34,100 [businesses] could lose small business eligibility for Federal Government programs” (while 35,200 others could gain eligibility). 69 Fed Reg. at 13140. Although SBA rationalizes that not all of the affected businesses participate in SBA’s programs, SBA’s best case scenario that only 1500 *participating* small businesses will lose eligibility is still significant, given the potentially severe impact that losing eligibility could have on those small businesses affected. *Id.* (“Overall, SBA estimates that fewer than 3,000 businesses . . . will be directly affected . . . about half of these businesses would gain eligibility while the other half would lose eligibility.”). Under these circumstances, the Section cannot agree

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 3

with SBA's "strong[] belie[f] that the benefits of simplification outweigh any impact on SBA's programs or on other Federal small business programs." 69 Fed. Reg. at 13134.

Eligibility as a small business affords valuable competitive benefits to firms in government procurement (such as eligibility to compete for procurements that are "set-aside" for small businesses and eligibility to participate in designated procurement programs such as the Section 8(a) program, the Section 8(d) subcontracting program, veteran-owned small business programs, and the HUBZone program, among other things). As SBA itself recognizes, many small businesses "have made economic and business decisions" aimed at maintaining their eligibility for SBA small business programs. 69 Fed. Reg. at 13132, fn. 1. Under the proposed rule, thousands of currently eligible firms would lose their eligibility through no fault of their own and, in many cases, the rule would directly undermine the critical business plans that these firms invested substantial time and resources in developing. The Section is of the view that the significant harm that would befall these firms in the face of what should be a neutral and non-substantive rule cannot be reconciled with the Government's oft-stated policy of treating all of its contractors fairly, justly, and equally.

The proposed changes will have far-reaching effect beyond federal government contracting. Many state and local government entities and agencies adopt the SBA size standards for making size determinations in their small business contracting programs. In addition, the U.S. Department of Transportation ("DOT") follows the SBA standards in determining eligibility for small business, SDB, and other set-aside and preference programs it administers and for those conducted by state departments of transportation funded by the DOT. If the SBA makes the proposed changes, the DOT may chose also to adopt the new standards or, if it does not, a small business bidder may be eligible under one program and not under the other. This has the potential for creating great confusion and disruption in the small business contracting community.

The Section is also concerned that SBA has failed to sufficiently assess the impact on the procurement system as a whole if the proposed rule is adopted. It is quite troubling that the SBA has not analyzed the impact of the subtractions and additions on the federal procurement regime for small business, including prime contractor-subcontractor relationships. Do the eliminated companies perform a substantial amount of federal contracts? What about the added firms? What is the

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 4

overall impact on the small business contracting goals? None of these questions appears to be addressed in SBA's proposed rule.

### **B. The Full Impact Of The Rule On Small Businesses Would Seem Greater Than That Estimated By SBA**

From the proposed rule, it seems questionable that "only" 34,100 businesses out of approximately 22.9 million small businesses in the United States would lose their small business status under the proposed rule. The Section believes a more complete statement of the economic analysis that led to this conclusion, and the impact on particular industries, should be published for public comment.

One particular concern is use of industry-wide receipts-to-employees ratios to estimate correlative employee standards for each industry. This algorithm appears capable of providing only rough justice. The ratio is an "average" figure for a whole industry. It seems likely that using an average ratio would cause many small businesses in every industry to lose eligibility. Using an average, by definition, means that certain businesses had a receipts-to-employees ratio *below* the average. Those small businesses near the current receipts-based size standard that have a receipts-to-employees ratio below the industry average ratio are at greatest risk to lose their small business size eligibility by virtue of the imposition of an employee-based size standard developed on an average ratio.

The Section is equally concerned with the process of selecting the new size standards by "rounding down." After applying the industry-wide receipts-to-employees ratio and thereby calculating a number of employees that correlates to the current receipts-based size standard, SBA then proposes to round down. For example, for industries where SBA calculates the correlative average number of employees to be from 51 to 74, SBA proposes to set the new size standard by rounding down to 50. *Id.* at 13132. Although SBA proposes to round up to 100 employees for some industries, *id.* at 13133, the impact of rounding down as the general rule would seem likely to cause many current small businesses to lose their small business size status. The Section requests that SBA's complete, detailed methodology for calculating the likely impact on the nation's 22.9 million small businesses be published for review.

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 5

### **C. It Is Doubtful That Employee-based Standards Will Be Simpler Than The Status Quo**

SBA asserts that its primary basis for the proposed rule, which would convert 37 of its receipts-based size standards to 10 employee-based standards, is to simplify the size determination process. Nevertheless, SBA's proposed restructuring of the standards by converting current receipts-based standards to employee-based standards would not significantly simplify the size determination process. The Section's first comment to this assertion is that *any change* to the basis for calculating size is likely to generate uncertainty, confusion, and mistakes for small business across the nation that do not necessarily monitor regulatory changes. Thus, the benefits of the change would have to outweigh the inherent disruption and inefficiencies that it may cause.

Second, the proposed conversion to employee-based standards would require small businesses to spend more time and effort continuously recalculating their size status. Under the proposed rule, all small businesses must determine size eligibility by averaging all of their employees by pay periods for the preceding completed 12 calendar months. 13 CFR 121.106(b)(1). This is a more tedious exercise than determining size eligibility by averaging "gross receipts," as set out in a companies' tax submittals for the past three completed fiscal years. 13 CFR 121.104(a)(1) and (b)(2). Although neither measure should be too difficult for a company to calculate, a firm under a current receipts-based standard only has to calculate its size eligibility on one occasion each fiscal year. A firm converted to a new size standard, on the other hand, could have to recalculate its employee count on a monthly basis under the new rule. Moreover, for those businesses that will be subject to the dual employee and revenue caps, the proposal would make things far more complicated and simplify nothing.

On the whole, the complexity of the current system would not, in any measurable fashion, be reduced. There would be no change in the processes involved in determining either the status of a business or the classification of contracts. There would remain the identical bewildering array of 1,151 industries and 13 sub-industries. The steps needed to determine size are the same. The only change is that there is a reduced field of possible answers to the same number of questions.

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 6

**D. The Proposed Rule Would Have Several Significant Negative Collateral Effects On Small Businesses**

The Section is also concerned that the proposed rule would have several significant negative collateral effects on small businesses. Specifically, the rule, as proposed, would compel small (primarily service) firms to:

1. Reduce employee counts to fit or remain under the new size standards. This could motivate such firms to lay off employees and/or require remaining employees to work more often on an overtime basis.
2. Shift future hiring away from entry level (lower revenue) employees to senior (higher revenue) employees in an effort to keep total employee counts down. This could lead to decreased contracting options and higher contract prices to the Government.
3. Shift current and future employment practices away from part-time or job sharing arrangements (because the new rule would count every employee, including part time and temporary employees, as full employees in accordance with 13 CFR § 121.106). This will cause small businesses to be less flexible and less competitive in labor markets *vis a vis* their large business competitors and will have a negative impact on employees of small businesses who desire or require flexible working arrangements.
4. Place greater reliance on subcontracting rather than on using a high percentage of self-performance. Unlike a receipts-based size standard, an employee-based size standard discourages small businesses from performing more contract work than minimally necessary to comply with the subcontracting limitations set out at 13 CFR § 125.6.
5. Convert current employees to “independent contractor” status, which is generally less advantageous to the worker and therefore could make it more difficult for small businesses to retain and recruit talented personnel.

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 7

**II. The Section Recommends that the SBA Modify The Proposed Rule To Mitigate The Harm that Would Be Caused to Certain Currently Eligible Small Businesses or Alternatively Withdraw the Rule to Allow for More Coordination With Industry Before Another Proposed Rule Is Promulgated**

The Section encourages the SBA to withdraw the proposed rule and perform more industry-specific analysis of the size standards in conjunction with industry before promulgating another proposed rule. Alternatively, given the problems with the proposed rule, the Section recommends that the SBA modify the standards and/or build in provisions that would mitigate the harm that could be caused to currently eligible small businesses.

1. Study the needs of small business and the impact of major change prior to drafting a proposal. For the reasons discussed above, the Section suggests that the current proposal be withdrawn, that a working group be established including both government and industry, that public hearings be held, that adequate and appropriate data be assembled and that the working group generate a publicly-available report with recommendations that could be used as the foundation for proposing change.

2. Raise the employee-based standards. Alternatively, given that SBA's conversion factors are imprecise, the Section believes the conversion methodology should favor eligibility. In this regard, because the SBA has based its conversion methodology primarily on receipts-to-employee ratio, SBA is penalizing those firms that have receipts-to-employee ratios that are *below* the average ratio assumed by SBA.

Additionally, it is not clear that SBA's use of 1997 census data, adjusted merely for inflation, is an accurate indicator of current size for all industries. The SBA has apparently failed to consider factors called out in 13 CFR 121.012(a) for establishing size standards in proposing to restructure its size standards in this instance. Here, SBA regulations compel a review by SBA of the "economic characteristics comprising the structure of an industry, including degree of competition, average firm size, start-up costs and entry barriers, and distribution of firms by size. . . . technological changes, competition from other industries, growth trends, historical activity within an industry, unique factors occurring in the industry which [sic] may distinguish small firms from other firms, and the

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 8

objectives of its programs and the impact on those programs of different size standard levels.”

3. “Grandfather” currently existing small businesses. At a minimum, SBA should maintain status quo by not disqualifying currently eligible firms. SBA could accomplish this by building into the rule mechanisms to “grandfather” currently eligible small businesses under current receipts-based standards for some period of time, at least until the end of the current fiscal year, for each such business when it would have to make the usual calculation of its AAR for the preceding three years. For example, SBA could create a dual standard that could be met by a company certifying it is either (1) eligible under the new employee standard, or, alternatively (2) eligible under the current receipts-based standard. Presumably, only those companies that are not small under the new employee-based standard would bother to look to the alternative receipts-based standard. This added step would not likely be considered too burdensome to those small business that would otherwise lose their small business eligibility.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,



Hubert J. Bell, Jr.  
Chair, Section of Public Contract Law

cc: Patricia H. Wittie  
Robert L. Schaeffer  
Michael A. Hordell  
Patricia A. Meagher

Mr. Gary M. Jackson  
Assistant Administrator for Size Standards  
May 17, 2004  
Page 9

Marshall J. Doke, Jr.  
Mary Ellen Coster Williams  
Norman R. Thorpe  
Council Members  
Chairs and Vice-Chairs of the  
Small Business and Other Socioeconomic  
Programs Committee  
David Kasanow