

# SIZING UP SMALL BUSINESS: SBA'S FAILURE TO IMPLEMENT CONGRESSIONAL DIRECTION

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## HEARING

BEFORE THE

### SUBCOMMITTEE ON CONTRACTING AND WORKFORCE

OF THE

### COMMITTEE ON SMALL BUSINESS

### UNITED STATES

### HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

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HEARING HELD  
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## **SIZING UP SMALL BUSINESS: SBA'S FAILURE TO IMPLEMENT CONGRESSIONAL DIRECTION**

**THURSDAY, JUNE 4, 2015**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON SMALL BUSINESS,  
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE,  
*Washington, DC.*

The Subcommittee met, pursuant to call, at 10:05 a.m., in Room 2360, Rayburn House Office Building, Hon. Richard Hanna [chairman of the Subcommittee] presiding.

Present: Representatives Hanna, Knight, Bost, Hardy, Chu, Lawrence, Takai, and Clarke.

Chairman HANNA. I call this hearing to order. I want to welcome Congressman Mark Takai, who is joining us today as the new ranking member of this Subcommittee.

Welcome. I look forward to working with you. I look forward to a hearing in Hawaii, incidentally. That might be not a bad thing.

Mr. TAKAI. Everyone is invited.

Chairman HANNA. Also, I would like to welcome Congressman Mike Bost, who is sitting in on this hearing today.

The topic of today's hearing goes to the essence of what we do as a Subcommittee since it deals with who we consider a small business. When we ask who qualifies as a small business, the answer to that question has ramifications for all the Small Business Administration programs. The answer also governs which companies are eligible for the \$200 billion in prime and subcontracts each year.

The answer isn't necessarily a simple one. A small aircraft manufacturer isn't going to look like a small architectural firm. If you ask most businesses, they will tell you that they are small, but that their next largest competitor isn't a small business. For these reasons, Congress gave the SBA the ability to decide which firms are small on an industry by industry basis. However, we require that the SBA base these decisions in a rigorous rulemaking process.

Unfortunately, today's hearing highlights a problem with that process. During the 112th Congress, the Small Business Committee strengthened the rules governing how the SBA defines a small business. This legislative change, which was signed into law on January 2, 2013, was prompted by complaints from industries such as architects, engineers, and technology service providers that the size standards do not reflect the reality of who they were in their businesses.

However, 2-1/2 years later the SBA has yet to implement the changes that were made during the 112th Congress. Indeed, a re-

cent proposed rule ignored these important bipartisan statutory changes. At the time, the Committee submitted comments warning the SBA that unless they withdrew the proposed rule they were courting a lawsuit they couldn't win. The SBA is proceeding with this proposed rule and says it will be implementing the statutory changes sometime next year.

In the interim, they are deciding whether the size standards that govern tens of billions of Federal contracts each year. Currently, firms in these industries have little recourse. They can sue in Federal district court at a great cost of money and time that they can ill afford.

I look forward to hearing from today's witnesses about the effects of the SBA's failure to comply with these statutory changes. The Subcommittee also welcomes any comments you may have on Congressman Bost's proposed solutions to the problem, H.R. 1429, the Stronger Voice for Small Business Act of 2015, which passed the House as part of this year's National Defense Authorization Act.

The testimony collected today by us will go to the SBA, to the Office of Management and Budget, in a effort to further inform how the SBA is promulgating size standards.

I now yield to the ranking member for his opening comments.

Mr. TAKAI. Thank you, Mr. Chairman, and thanks for holding today's hearing.

Small business plays a critical role in America's economy. I come from Hawaii where over 90 percent of the businesses are considered small and more than 50 percent of the workforce works for a small business.

Over the years, Congress has created numerous program set-asides, tax preferences, and SBA loan programs to help these small businesses succeed. However, the advantages conferred by these programs have led to heated debate over what is truly a small business and acceptable small business size standards to govern eligibility.

The definition of what exactly is a small business has eluded us in many different areas in policy as the definition may work for a business in one context but may be entirely inefficient in another. On numerous occasions, the SBA proposed a comprehensive revision of its size standards, but the end result was a confusing patchwork of regulation.

The Jobs Act of 2010 attempted to clarify these standards, yet in conducting reviews various stakeholders raised concerns about the oversimplification of the process and questioned whether true small businesses were being left out of the definitions.

To address these concerns, provisions were included in the NDAA of 2013 that required SBA to continue its process only if certain data was made publicly available prior to the issuance of any proposed size standards revisions. But for reasons unclear to us, SBA has yet to implement these requirements and small businesses continue to be disadvantaged by these reviews.

Without an accurate small business definition, firms are excluded from programs designed to aid in their growth and allow them to create more jobs. For example, last year, small entities accessed over \$30 billion in capital using SBA loans. Many businesses use loan proceeds to keep their doors open, retain employ-

ees, and create new jobs. However, firms deemed other than small were precluded from accessing this capital.

Not only does this process harm business operations, it impacts Federal protections guaranteed to small firms. If a business is not considered small, agencies are neither obligated to review the impact that regulatory changes have on small firms nor offer alternatives. Most importantly, businesses excluded from the definition are barred from participating in various contracting programs which awarded almost \$100 billion in contracting dollars just last year.

On the other hand, if a size standard is overinclusive, businesses that would otherwise be considered large would be able to compete in these programs, depriving small businesses of contracting opportunities.

As previously attested before this Committee, small businesses already have difficulty competing in the Federal marketplace. With some large businesses already receiving small business contracting dollars, it is vital the size process be fair and balanced.

Today we will hear from multiple people that have been affected by the process currently in place. I want to be clear that we are not advocating for one size standard over another, but rather looking for a transparent process that results in sizes reflective of industry standards.

In advance of the testimony, I want to thank all the witnesses for their participation and insights into this important topic.

Thank you, and I yield back.

Chairman HANNA. Thank you.

Our first witness is Jim Fontana, cofounder and managing partner of Dempsey Fontana, PLLC. He has over 30 years of experience as an attorney, specializing in government and commercial contracts. He is testifying today on behalf of the Small Business Value Added Reseller Consortium.

Sitting next to him is our second witness, Stephen Charles, cofounder and executive president of immix, Inc. Mr. Charles is the coauthor of "The Inside Guide to the Federal IT Market," a resource for technology companies interested in doing business with the government. Immix's group manages the contracts of many small businesses, working with more than 600 value added resellers.

I now yield to my colleague, Congressman Bost, to introduce our next witness.

Mr. BOST. Thank you, Chairman and Ranking Member, thank you both for being involved with this hearing today and allowing me to introduce the next participant.

Mr. Ronald Reim serves as executive vice president of Oculus, Inc., a small business architectural design firm with offices in St. Louis and Dallas. While Oculus is not physically located in my congressional district, many of the employees actually live in the 12th Congressional District of Illinois. The company has also worked on a project in southwest Illinois, which also include projects at Scott Air Force Base. He is testifying here today on behalf of the American Institute of Architects.

Mr. Reim, thank you for being here, and I look forward to hearing your testimony.

Chairman HANNA. I now yield to Ranking Member Takai to introduce our fourth witness.

Mr. TAKAI. Thank you, Mr. Chairman.

It is my pleasure to introduce Mr. Roger Jordan. Mr. Jordan is the vice president of government relations at the Professional Services Council, a national trade association of government, professional, and technical services industry businesses. At PSC, he is primarily engaged in leading PSC's legislative efforts on a number of issues impacting Federal acquisition policy.

Prior to joining PSC, he worked for 10 years as executive director of the Small Firm Council and the director of the international and state legislative programs at the American Council of Engineering Companies.

Welcome, Mr. Jordan.

Chairman HANNA. Mr. Fontana, you may begin.

**STATEMENTS OF MR. JIM FONTANA, DEMPSEY FONTANA, PLLC, RESTON, VA, TESTIFYING ON BEHALF OF THE SMALL BUSINESS VALUE ADDED RESELLER CONSORTIUM; MR. STEPHEN CHARLES, COFOUNDER, EXECUTIVE VICE PRESIDENT, IMMIXGROUP, INC., MCLEAN, VA; MR. RONALD REIM, EXECUTIVE VICE PRESIDENT, OCULUS, INC., ST. LOUIS, MO, TESTIFYING ON BEHALF OF THE AMERICAN INSTITUTE OF ARCHITECTS; AND MR. ROGER JORDAN, VICE PRESIDENT OF GOVERNMENT RELATIONS, PROFESSIONAL SERVICES COUNCIL, ARLINGTON, VA**

**STATEMENT OF JIM FONTANA**

Mr. FONTANA. Thank you. Good morning, Chairman Hanna, Ranking Member Takai, and members of the Subcommittee. As you stated, my name is Jim Fontana, founding member of Dempsey Fontana law firm. I thank you very much for the opportunity to testify today.

Today I am going to chat and testify on behalf of 13 small information technology value added resellers. That is a mouthful, so we will just say IT-VARs. These 13 companies have formed a coalition called the VARC, Value Added Resellers Coalition. The companies are representatives of thousands of other, similarly situated IT-VARs around the Nation that compete on individual Federal agency small business set-aside solicitations or multibillion-dollar agency program requirements only for small business.

The VARC members fall under various programs, including the Small Disadvantaged Businesses, Women-Owned Businesses, Veteran-Owned Businesses, and small businesses that are located in what we know are HUBZones.

On behalf of the VARC, I am expressing my support for H.R. 1429, introduced by Representative Bost, called the Stronger Voice for Small Business Act of 2015. The underpinnings of my support are twofold. First, businesses selling goods and services to the government that are certified as small under SBA regulations are subject to the SBA's changing size standards. And as was mentioned and as you are aware, the Small Business Jobs Act of 2010 directs the SBA to conduct a detailed review of all size standards every 5 years.

The only avenue for these small companies to challenge an SBA size standard is for such companies to file Federal lawsuits under the Administrative Procedures Act. The Stronger Voice Act will allow small firms a quicker and much less expensive administrative forum to challenge such size standards, as opposed to the mounds of pleadings, motions, discovery, hearing-related documents. At the end of the day, these small companies will be afforded a much less expensive forum than going to Federal court or resorting to full-blown litigation.

Secondly, the administrative forum created by the Stronger Voice Act is particularly needed at this time, given the SBA's recent proposed deletion of the 150 employee-based size standard contained under Note 18 of the NAICS Code 541519, which applies to IT-VARs. The deletion of this employee size standard would leave only the \$25.5 million revenue-based size standard under that code.

I say \$25.5 million. That is what the SBA used to do its analysis. The real standard was at the time \$27.5 million. So I will just use \$27.5 million.

I will say that the SBA had mentioned to me, in a meeting with them on March 24, that they had written a letter to the full Committee stating that they would finalize the rule sometime this summer.

Now, there are a number of reasons why this proposed rule with respect to this particular NAICS code applying to IT-VARs should not be implemented and represents a valid backdrop for the Stronger Voice Act. And so in the interest of time, I will just summarize those reasons.

First, the SBA's decision to eliminate the IT-VAR employee size standard is based on outdated data that claims that the IT-VAR, the 150-employee count, is more or less equivalent to \$27.5 million in receipts under this NAICS code. And just quickly, that assumption is clearly wrong.

I have attached to my full statement data a survey of some of the major government-wide acquisition contracts, or GWACs, that show clearly, just on that data—it is not perfect data, but just on that data—that at least 43 percent of those IT-VARs that were considered small will not be considered small if this proposal is put through. And so just doing our own analysis, we find out that that percentage is much higher.

I will add that in 2002, going into 2003, the SBA, when they first established this size standard, had concluded, and I will just quote briefly from the language of that notice, quote: "An employee size standard is considered a better measure of the size of IT-VAR operations than receipts."

The SBA based this conclusion on a very exhaustive and detailed quantitative analysis, but no such analysis was performed under this proposed rule. Frankly, I don't think those numbers are there. I don't think that the SBA can provide any such explanation under any objective standard why the IT-VAR business is different today than it was back then.

The bottom line is that the proposed rule is not supported by accurate and relevant market data, and it should not be passed. I think that the SBA should consult further with the procuring agencies and affected small IT-VARs as well as this Subcommittee.

In addition, Congress should adopt the Stronger Voice Act to allow small businesses the ability to administratively challenge these proposed changes to fairly protect their interests.

Again, I thank you for the opportunity to testify at this hearing. I would be pleased to answer any questions you or any member of the Subcommittee may have.

Chairman HANNA. Thank you.

Mr. Charles.

I should have mentioned there is a 5-minute rule, but we want to hear what you have to say.

#### **STATEMENT OF STEPHEN CHARLES**

Mr. CHARLES. Thank you, Chairman Hanna, Ranking Member Takai, and members of the Subcommittee. Thank you for this opportunity to testify on issues related to small business contracting and size standards. My name is Steve Charles, cofounder of the immixGroup, where for two decades I have worked to help information technology manufacturers succeed in the government marketplace.

Since our founding in 1997, with my partner and I, immixGroup has grown into a recognized leader in the public sector IT marketplace representing more than 250 manufacturers as a distributor to more than 600 value added resellers, most of them small businesses. We are a top 10 IT 70 GSA multiple awards schedule contractor with IT product sales over \$420 million in fiscal year 2014.

On March 31, immixGroup was acquired by Arrow Electronics, a Fortune 200 company, so we are no longer small by any standard. And moving forward, as a public sector subsidiary of a global IT distributor, we do plan to continue our involvement in small business and product procurement issues on behalf of the hundreds of channel partners who source IT products from us.

We believe it is critically important for the Federal Government to maintain small business size standards that accurately represent each industry sector and subsector and support efforts to ensure that SBA's review of size standards and NAICS code updates are based on accurate, relevant data performed in a statutorily correct, transparent, and thorough manner.

We also support an enforcement mechanism to formally challenge size standards through the SBA Office of Hearings and Appeals, such as that proposed in the Stronger Voice for Small Business Act of 2015 introduced by Representative Bost and cosponsored by our own Congressman, Representative Connolly.

A key recommendation of immixGroup is for SBA to analyze Federal procurement data, in addition to census data, as part of the size standard review process. By way of example, we look at the SBA's recent proposed size standards rule eliminating the IT-VAR exception, also known as Footnote 18 from NAICS Code 541519, which is entitled "Other Computer Services." In its proposal, the SBA notes that the lack of data on characteristics of firms involved in IT-VAR activities to evaluate the current 150-employee size standard also justifies SBA's proposal to eliminate the IT-VAR subindustry category.

Indeed, immixGroup is not aware of any research conducted to justify this subindustry. We firmly believe that if a nonpartisan

independent review were conducted on orders placed pursuant to multiple award delivery order contracts set aside under the IT-VAR exemption, the research would clearly show how agencies' use of this exception to limit competition for the purchase of products has been confusing and misguided, categorizing many billions of dollars, about \$10 billion to \$12 billion a year spent for products manufactured by large businesses as "Other Computer Services" under this NAICS code, while inhibiting the ability of otherwise qualified small contractors to compete for Federal IT product orders.

The use of Footnote 18 in this way excludes a large segment of prospective small business contractors and violates a contracting officer's obligation to designate a NAICS code that describes the principal nature of the product or service being acquired.

According to current statutes, should a mix of products and services be required, the NAICS code chosen is supposed to represent the industry accounting for the largest percentage of the contract price. We believe that for the vast majority of the nearly 60,000 contract actions per year conducted pursuant to 541519 this is not the case.

For these reasons, immixGroup supports the SBA's objective of striking the Footnote 18 exception. Our hope is that issues related to eliminating this exception can be resolved in a way that promotes clarity, consistency, and confidence in how socioeconomic policy is being implemented within the procurement system for the purchase of products.

Related to SBA's IT-VAR exception proposal, the SBA released another proposal clarifying COTS software and the use of the non-manufacturer rule. We support these as well. Every day we see solicitations requesting a quote for items manufactured by a large business that are set aside for small businesses with no NMR waiver, creating a Catch-22. Meanwhile, all the dollars obligated count toward meeting the agency's small business goals.

We respectfully request that before Congress considers increasing the statutory government-wide small business prime contracting goals, it requests order level line item data to quantify the extent of this practice across all product industries.

In conclusion, we thank the Subcommittee for considering these commonsense measures to ensure that SBA conduct size standard evaluations are based on relevant data in full compliance with the law. Thank you for this opportunity.

Chairman HANNA. Thank you.

Mr. Reim.

#### **STATEMENT OF RONALD REIM**

Mr. REIM. Chairman Hanna, Ranking Member Takai, and members of the Subcommittee, thank you for the opportunity to testify today on behalf of my firm and on behalf of the American Institute of Architects on the critical issues of SBA size standards.

My name is Ronald Reim. I am an executive vice president and founding principal of Oculus, Inc., a full service architectural and strategic facility planning, interior design, and move management firm with offices in St. Louis and Dallas, Texas. In addition to serving these communities, we work with a number of Federal agencies and do projects all across the country.

My firm is grateful for the assistance that the SBA has provided. Our designation as a small architectural practice has helped our company bridge into more complex and interesting and meaningful projects, giving us an avenue to work on private sector work as well through gaining this experience.

Our SBA designation also helped us keep our doors open during the recession. During that time, our firm was forced to severely cut staff as our private sector work dropped off precipitously. For the most critical 6-month period, we cut pay 20 percent for our senior people and laid off staff as a necessary survival tactic, but our Federal Government work provided an avenue for us to essentially keep our doors open, and the SBA designation truly helped in that.

Dramatically increasing the size standards, as the SBA proposed in 2011, would create a ripple effect for us much like the recession, we think. It would just simply change the competitive nature of our industry, opening up the door to much larger competitors in our arena. The SBA proposed lumping together architecture and engineering firms into a single massive size standard that would have effectively defined 98 percent of the architectural practices as small.

Substantially raising the size allowance would for all intents and purposes eliminate Oculus' ability to compete for these Federal contracts for set-aside projects. It would reclassify mid- to large-size firms, essentially making David and Goliath the same. Yet competitively we are very different organizations and companies.

The current size limitation provides opportunities for truly small businesses to have a legitimate shot at performing Federal work and opens the door for us to get in. And gaining access to restricted set-aside contracts is essential for us to essentially have a shot at it. This allows an emerging firm to gain experience with these types of projects in the government arena that allows us to build a portfolio that we then can compete on a more even keel with larger companies, and that is essential for us to be able to survive. You don't get Federal projects unless you have that portfolio, and this is the way for us to build it.

Had the proposed 2011 size standard been put into place, it is very likely that we would have decided it was just too difficult to even compete for Federal work and taken a different direction, cutting off a very vital avenue for us to gain those experiences. The SBA is required to review and adjust size standards only once every 5 years. Five years of being cut out of this type of work would be devastating to our firm. It is just we couldn't survive that length of time.

This is why it is essential that the SBA gets the size standards right. It is also why I am pleased that members of this Committee, led by Representatives Bost and Connolly, have introduced House 1429, the Stronger Voice for Small Business Act. Giving us this avenue to be able to question and challenge these designations in a more cost-effective manner is absolutely essential as well. Litigation is just not really an option for a small company like mine.

I am pleased that the House incorporated this bill into the defense bill, and I hope it can become law later this year. Related to the issue of size standards and how contractor payments are calculated in net revenue of an architecture firm, as much as 50 per-

cent of our revenue passes directly through our company as the team leaders on these contracts, so it is money that goes to us directly through to our subconsultants. We have very little, essentially, in that process at all to manage that.

To suggest that a firm is not a small business merely because it handles the revenue of these other companies, however briefly, before using it to pay other firms is simply unfair. The SBA could easily address this issue by not counting that money passing through those firms or changing the standard through which how it designates small business.

In conclusion, the SBA is an immensely valuable institution that has helped innumerable small businesses. The SBA's vast reach, however, means that even minor changes to the rules and policies can have dramatic consequences for small businesses. Therefore, we ask that the SBA follow the letter and intent of the law and ensure that any size standard adjustments be made to reflect current market conditions.

I would like to thank Chairman Hanna and Ranking Member Takai and the distinguished members of the Subcommittee. Thank you.

Chairman HANNA. Thank you.

Mr. Jordan.

#### **STATEMENT OF ROGER JORDAN**

Mr. JORDAN. Chairman Hanna, Ranking Member Takai, thank you for the opportunity to testify today.

Prior to 2009, PSC was calling upon SBA to undertake a thorough analysis of the size standards, particularly for the 54, or the professional, scientific, and technical services sector in which many PSC member companies operate. We viewed this review as necessary because it had been years since SBA had last conducted a thorough review.

SBA began such a review in 2009 by first developing a methodology to calculate size standards based on five factors, only one of which was focused on the Federal contracting marketplace. PSC commented on the methodology, which was finalized without substantive change.

Subsequently, in March of 2011, SBA issued a proposed rule to revise size standards for 36 industries in the 54 sector. For most industries, the increase in the size standards were fairly substantial. For example, most size standards that had been established at \$7 million in annual gross receipts were increased to either \$10 million or \$14 million. That increase provided much-needed flexibility for small firms to mature while still having access to restricted competitions. However, for other industries, primarily for computer-related services, that size standard remained essentially stagnant.

In our comments on the proposed rule, we raised several concerns, and our views remain unchanged. Our concern is that SBA is ignoring the fact that computer-related services has undergone and continues to undergo a significant change over the last 25 years. The Federal Government is purchasing more of these services than at any time in history, and companies across industry are focusing on providing a comprehensive set of solutions to the Fed-

eral Government that include a combination of telecommunications, information technology, and other solutions and services. Yet SBA proposed raising the size standards for those categories only by \$500,000, from \$25 million to \$25.5 million.

Additionally, SBA established a common size standard for a handful of IT-related industries, even though the industry data supported a distinct same size standard for some of those industries. For example, SBA's own analysis shows that for computer facilities management services the calculated size standard was \$35.5 million, but SBA still chose to retain the lower common size standard for this category.

Therefore, by establishing the common size standard that incorporates this NAICS code and other computer-related NAICS codes at that common level of \$25.5 million, SBA has eliminated legitimate small businesses from being able to qualify as such. PSC's comments to SBA focused heavily on this point.

However, in its 2012 final rule, SBA declined to adopt our recommendation that common size standards be avoided altogether or that they default to the higher threshold to avoid negatively impacting small businesses. To this Committee's credit, you recognized that reliance on a common size standard could have a negative effect on small businesses, and in May of 2011 a hearing was held on the issue at which PSC provided testimony.

Later, legislation was enacted via Section 1661 of the fiscal year 2013 National Defense Authorization Act that requires SBA to justify the use of common size standards. Unfortunately, the NDAA language was enacted after the SBA final rule changing the size standards for the 54 sector was complete and no SBA justification has been provided. Thus, legitimate small businesses have been denied the ability to compete for set-aside contracts since the final rule went into effect.

An additional effect is that companies have been denied the ability to increase their revenues while maintaining their small business size status. In the computer facilities management services industry, for example, firms that were close to exceeding the \$25 million size standard in 2012 would have been able to grow their business to \$35.5 million while still being afforded the benefits that come with being a small business Federal contractor.

The added growth that the higher size standard would have provided to these companies could have eased their transition into the full and open competitive market. Instead, the result has likely been that businesses have either refrained from growth in order to maintain their small business status or they have had to transition exclusively into the full and open market much sooner than they would have had SBA actually followed its own methodology.

We expect SBA to undertake a required review of the 54 sector within the next 2 years, and while SBA should not be allowed to ignore the law in the interim, we are disappointed that they have not proactively made necessary updates. We certainly look forward to SBA complying with Section 1661 at the time of the next review.

PSC also reiterates its support for an SBA size standard methodology that gives more weight to the Federal marketplace dynamics or creating a completely separate set of size standards to be used for Federal procurement purposes only.

Lastly, it is important to recognize that 1661 is one of many small business contracting statutory provisions enacted since 2010. This Committee has been vigilant about holding SBA and the FAR Council accountable for implementing those provisions, and PSC shares the frustration expressed at the recent Subcommittee hearing about the length of time it has taken to complete implementation.

As such, PSC supports efforts to move towards concurrent and collaborative SBA and FAR rulemaking to speed the implementation process. It is simply unacceptable that implementation of enacted small business provisions has taken 3 or more years to fully implement.

Mr. Chairman, this concludes my testimony. Thank you again.

Chairman HANNA. Thank you.

I am going to yield the first question to Mr. Bost.

Mr. BOST. Thank you, Mr. Chairman.

Mr. Reim, I am going to just go right into it. I know that you have done work for Scott Air Force Base and Department of Veterans Affairs, but your business obviously works for other projects besides that. How is working on Federal projects different than in the private sector?

Mr. REIM. In the private sector, we compete with large companies and small businesses. What is different about it is that the Federal work offers us the ability to team with large companies and gain parallel experience along with them. So prime contracts, for example, where we have large companies as our subconsultants give us expertise and allow us exposure to project types that we would never be selected for typically out in the private sector. Those would normally be primed by large firms and we might be the subconsultant to them.

So, for example, our work with the VA has allowed us exposure to very high-level projects in a planning and oversight role that then has opened the doors for us with our private clients as well. So, for example, our work with the VA has opened up project opportunities for us with local healthcare provider BJC on larger, more complex projects.

Mr. BOST. All right. Good.

So in your type of business with architecture, what is the level of competition that is out there, and how many are small and how many of you are you going head to head with the larger companies?

Mr. REIM. The vast majority of firms are small companies, but there is a big, extreme difference between firms providing architectural services that are independent architectural firms, like mine, and larger conglomerate firms that consist of a full array of product services and types, including construction and construction management, all disciplines of engineering, and there are essentially global companies doing it.

We are a local company providing local jobs and keeping expertise in the local community, and that is really important. I think that if companies like ours weren't allowed to essentially start and grow and use these types of tools to merge into or emerge as more mature companies, then there would be a separation of really big firms and really small firms not doing Federal work and really almost nothing in between.

Mr. BOST. Would you say that having the opportunity to compete on that level instead of everybody trying to go against the big dogs without any opportunity like this, beneficial for the taxpayer?

Mr. REIM. Yes, absolutely. I think that our small firm cost structures for the government are lower than large firms. Our overhead structure is lower. So we afford a good value for the Federal Government in competing on those projects, as well as we are able to put teams together that tap into the expertise that some of these larger firms obviously have, given their size and the number and types of projects they work on, to provide the same level of knowledge back to the government and a quality level to the service.

Mr. BOST. I have got one question for the whole panel, if I can. Have any of you actually had to go through the law suit process that, if the bill goes all the way through and passes, that you can go directly to the appeals process to the Small Business Administration? Have any of you had to go through the process right now of law suits for any changing of definition of a small business or not?

Mr. JORDAN. No, sir.

Mr. BOST. Okay.

Mr. FONTANA. Congressman Bost, I have been involved with lawsuits under the APA, Administrative Procedure Act, challenging agency decisions. You can challenge designations of NAICS codes, but not the decision to change the size standard of a NAICS code. So this would be a very new process.

Mr. BOST. Okay.

Mr. FONTANA. But they are daunting and they are expensive lawsuits, like any Federal lawsuit.

Mr. BOST. I have in my district right now a situation with a boot manufacturer that has been a small business and always been rated as small business, and a lot of the competitors are now arguing, and they are actually smaller than they were when they first got that standard. But I know they are going through that process right now.

Thank you, Mr. Chairman. I yield back.

Chairman HANNA. I yield to Ranking Member Takai.

Mr. TAKAI. Thank you, Mr. Chairman.

Mr. Jordan, in your testimony you discussed how SBA traditionally analyzes the five primary factors when making its size determination. You also discussed that the impact of government contracting should be given more weight. Why do you believe this is such an important factor?

Mr. JORDAN. Well, the Federal Government marketplace is much different from the commercial marketplace. The services and the solutions that our member companies are providing are usually a lot bigger, a lot more complex, a lot more comprehensive. And so we often see larger contracts. We have a larger barriers to entry, some government-unique reporting and compliance requirements, for instance, that businesses of all size must comply with. So you have to be a little bit more savvy to enter the marketplace, which usually means you are a little bit bigger.

And back to my point on the size of contracts, I mean, we continue to see some very large contracts being set aside for small businesses, and that is not necessarily a bad thing, but sometimes

the Federal agencies go a little bit too far. There is a great example within NGA that is moving right now that would set aside a contract under a size standard of \$15 million, and it is a 5-year contract with a ceiling of \$850 million and they want to make award to four to eight companies.

So when you look at that and you do the math, it is somewhere in the neighborhood of \$20 million to \$40 million per year per company in terms of what they would need to perform under a size standard of \$15 million. It just doesn't make sense.

Now, there are certainly other cases where contracts are structured in the right way, but I think it paints a picture of the requirements are often larger, more complex, and therefore you don't get the kinds of one- or two-man small firms that are operating in the commercial space.

Mr. TAKAI. Thank you.

So we have seen agencies, and you mentioned one in particular, bundle contracts. I am assuming the one you just mentioned is a bundled contract. This, along with the predominance of multiple award contracts, has caused the overall value of contracts to increase significantly. Do you believe these developments have caused businesses to outgrow their size standards at a higher rate than if they won single award contracts?

Mr. JORDAN. Absolutely. We are hearing that more and more frequently, that, again, because of the size of these contracts, you can win a single award and almost overnight eclipse your size standard.

Now, that is not necessarily always a bad thing, but if it is a 5-year contract and you are dedicating all of your small business resources to performing on that contract, what happens when that contract comes to conclusion? One, you are no longer eligible to bid on the work if they set it aside as a small business, and so you are going to lose that work when a competition comes around, and if you haven't built up your overall capacity, then you are going to see a precipitous drop in your revenue, and that is going to be a real business challenge.

Mr. TAKAI. So what would the size standards be for these types of situations as a result of these trends?

Mr. JORDAN. Well, it is hard to say. I mean, I continue to believe that each and every NAICS code needs to be assessed on an individual basis. And SBA has developed a methodology, it is fairly complex, and without getting into the nuances of that, I think that what they ought to be doing is applying that methodology consistently to all the NAICS codes and avoiding a reliance on common size standards where the individual NAICS codes that are included under that common size standard would be different. Why do we want to penalize any small business? It just doesn't make any sense. Just for the sake of efficiency for whom? Efficiency for SBA's process of establishing the size standards?

Mr. TAKAI. All right. So during the initial review of your organization's size standards, PSC requested additional information from the SBA to better inform comments you submitted. The NDAA provisions discussed here today were meant to better inform the public about how SBA arrived at their proposed size standards so that all relevant information was available. What effect could this informa-

tion have on the size standards process, as well as industry's ability to participate in the comment processing? You have got about 30 seconds to answer that one.

Mr. JORDAN. I think basically, sir, it comes down to transparency, and that just by requiring the SBA to submit a justification for why they have bundled NAICS codes together under a common size standard can help industry understand their approach, but also where we think that that approach is misguided, it gives us a little bit more information to push back on.

Mr. TAKAI. All right. Thank you.

I yield back.

Chairman HANNA. Thank you.

It would be nice if the SBA was here to also participate in this, but they are not.

The expectation is that H.R. 1429 will somehow settle some of this. With all the different NAICS codes and size standards and the proposal for more size standards, is the work, Mr. Fontana—or anybody—so subjective as to never be able to get it right, which in my mind would make the appeal process that more critical? And how do you view the appeal process in terms of resolution?

I mean, it is nice to be able to go to court, it is nice to have some kind of arbitration, but at the end of the day you want a resolution in a timely fashion that allows architectural firms and IT firms to have a fair shot in their own sectors. What would you like it to look like? What is your expectation, Mr. Fontana?

Mr. FONTANA. You mean of the appeal process?

Chairman HANNA. Yeah.

Mr. FONTANA. I think as the bill, as written, it is as near as you can get in terms of what that due process would be. You would be able to challenge it before the SBA, go before the SBA's Office of Hearings and Appeals, which is a fairly simple—compared to litigation—it is a fairly simple process. It would be like a small business size protest or a status protest. Their paper exchange is usually one each, it might be several others.

So it is a fairly simple process. And then after that you would have judicial review of that process if the parties so desire. So it does introduce a much less expensive process that small companies would be able to afford relatively.

Chairman HANNA. But are there teeth within that that you would like to see? I mean, it is one thing to win your own appeal. It is quite another matter to have the kind of broad change that you are appealing because what you are really saying is that this industry, this sector is not being treated fairly broadly, or you might not be there in the first place. Do you agree with that?

Mr. FONTANA. I agree with that in the sense that this is a fairly narrowly tailored bill. It has to do with the creation or revision of a size standard. So it is narrow in that respect. There is no other forum, other than going through the SBA comment period, as many have done, out of 170 there was overwhelming opposition to elimination of Note 18, or going to court. We took it a step further. We are having continuing dialogue with the SBA on this issue prior to their finalization of some rule.

But to answer your first question on the subjectivity, does the SBA never get it right under these circumstances, I can cynical and

say, yes, they never get it right. In this case, they just did not. They didn't follow the law, they didn't follow the Jobs Act, they didn't follow NDAA 2013. They got all the data wrong. The SBA said it would be a 1 percent impact. We are showing much, much more of that.

So having this type of mechanism, and I would doubt that this mechanism would be in place by the time the rule is finalized, but having this mechanism would allow these companies to challenge SBA in this case simply not following the law.

Chairman HANNA. Mr. Charles, would you like to respond?

Mr. CHARLES. Well, I too wonder what the effect of an appeal decision would be. Would SBA actually change course and modify the size standard of a particular NAICS code? I don't know. I am not familiar enough with the bill and the downstream implications.

I would like to add the perspective that I would hope that we could look at Federal procurement data in these discussions in addition to census data. We are looking at census data in terms of size of companies, and some of the other witnesses here have alluded to this point, that the Federal marketplace is a little different. And to my knowledge, SBA is not analyzing Federal procurement data at the NAICS code level, and further, is not analyzing procurement data down at the line item level in these orders, which would bring us a whole lot of information about whether or not Footnote 18 comports with other statutes.

Chairman HANNA. Thank you.

Mr. Reim, you mentioned almost in passing, and I have got about 30 seconds, that you see they are driving social and economic policy. What did you mean by that?

Mr. REIM. You know, if these codes change or the amounts, the limits, change dramatically, we would see the landscape for competition change dramatically, and it would often restrict small businesses from being able to gain an entree into that. And it is pretty much making a decision then that if you are not going to contract or not able to contract with the Federal Government, that you are locked out of that element of business.

Chairman HANNA. All right. Thank you very much.

I yield to Ms. Clarke.

Ms. CLARKE. I thank the chairman and ranking member. I also thank our witnesses here today.

Establishing up-to-date and pragmatic small business size standard methodologies is important for the entire small business sector. This is the determining factor behind many SBA assistance programs, such as capital access and technical assistance. And while I understand that the SBA faces a cumbersome task in constantly updating size standards to keep current with industry growth and inflation, I appreciate the concerns that you have put forth here today.

I want to ask if you could just drill down a little bit more on the bundling of the NAICS codes, because I think that there may be where some realignment and perhaps the remedy may exist. Mr. Jordan, you spoke about that, but I would like to hear from the panel. Thank you.

Mr. JORDAN. Sure. I will start.

So SBA is driving towards what they say is streamlining the size standard process, and so they want to, in my view, limit the number of different size standards that are out there. And again, to my point earlier, that makes little sense when you consider the variation and the dynamics of the vast number of industries that are comprised within the NAICS code structure.

And so to me it is almost as if each industry should be assessed on its own merits, and whatever that size standard, based on that, the SBA's own calculation comes out to be, that is really where they ought to focus. And again the example that I used in my oral statement was around the computer-related facilities where by SBA's own calculation they determined that the size standards for that NAICS code was \$35.5 million, yet they chose to go with a size standard that was \$10 million lower.

And so that meant that any companies that were in between that delta, essentially, by SBA's own definition, were small, but would be considered to be other than small, they would be ineligible to compete for small business set-asides. And to me, I think that is a fundamental flaw.

Ms. CLARKE. So let me ask, do you think there is realignment required or do you think that there needs to be a decoupling or debundling, if you will, and a breakdown of industry? Because I am just trying to think about capacity of SBA to do that level of assessment when you can be talking about hundreds of industries.

Mr. JORDAN. Well, let me be clear. I think that there certainly are circumstances in which creating a common size standard makes sense. For example, if you have a group of industries where the capabilities or the functions are essentially similar or there is a lot of overlap and the individual size standard determination determined by the methodology that SBA uses comes out and it is relatively the same, then by all means go ahead and use a common size standard, provide the justification, and I don't think you will get a lot of opposition from industry. But when you have a significant variation in those individual NAICS codes, then it doesn't make sense to bundle them.

So I think it is, to answer your question, a mix of both. In some cases, yes, it is fine, but in others it doesn't make sense.

Ms. CLARKE. Okay. Let me ask if you can please elaborate on suggestions that you have to improve the current size standard methodologies that affect your sectors.

Mr. JORDAN. I will start by again focusing on the Federal contracting marketplace. Again, it is very different, but it is only one of the five significant factors that the SBA uses to calculate size standards today. And there are factors like the impact on the SBA loan programs that they factor in, and I think that factor has a very minor impact. I mean, the companies that are operating in the Federal space are not necessarily the same companies that are seeking to access capital through the SBA loan program.

So to the extent that they are artificially keeping those size standards lower so they don't have a dramatic impact on loan programs doesn't make a whole lot of sense when you are looking at size standards through the Federal contracting lens.

Ms. CLARKE. Gotcha.

Mr. FONTANA. I will just add, I agree with Mr. Jordan's analysis on this. It is very simple. With this particular subindustry on IT-VARs or with any industry, the idea is for the SBA to understand the business, understand that industry or subindustry, use reasonable methodology, look at the market and the competitive impact data, which the law requires to make that reasonable decision, and that is it, but the SBA is not doing that here.

Ms. CLARKE. Thank you, gentlemen.

I yield back, Mr. Chairman.

Chairman HANNA. Ms. Chu.

Ms. CHU. Yes. I would like to address this to Mr. Reim. Last Congress I hosted a roundtable and heard from the architects in my district about the effect that size standards have had on their businesses, and they reported that the average size of architectural firms is less than 15 people, but the current size that the SBA has for architectural services is \$7.5 million, which they found to be very, very high. They were extremely concerned about the potential changes to the size standards and being forced to compete with larger firms that are not actually small.

From your perspective, is the current size standard for the architects, for your industry, is it too high?

Mr. REIM. I don't believe that it is. I think that when it was much smaller we actually for a time grew out of the size standard. I believe back the last standard was at \$4.5 million. We actually grew out of it.

In the current size standard, we might face that in a year or 2 as our company continues to recover from the recession and grow. But I think that if it goes up much higher than the \$7.5 million that it changes the playing field rather substantially, especially if it goes up to the newly proposed amount.

And even if it were to be raised, I think that one of the things is the speed at which it is changing. If it were to change from \$7.5 million to the \$19 million abruptly, then suddenly the landscape looks instantly overnight very different. If we were all told that it is going to migrate to a different number, that would be a much more acceptable transition to us.

But still, there is such wide variety in architectural firms, from large to small, and there are so many firms that are small, that the smaller, ours and down, I would say, would have a very difficult time gaining entry into that market, gaining the portfolio and experience they need to compete and to have the actual credentials to do the projects in that market if the standard goes up substantially.

Ms. CHU. What is the best indicator for an architectural firm size standard?

Mr. REIM. You know, again, because when I testified about the amount of pass-through revenue, we think that actually a better size standard would be the number of employees or a more accurate accounting of how much money is retained by the firm in terms of direct labor cost. We think that would be a much more accurate standard at least for our NAICS code.

Ms. CHU. And then there is this proposal to combine the architecture and engineering industries together under one standard.

And I wonder what you think about this and how does this impact the ability of truly small businesses to win government contracts?

Mr. REIM. Well, we don't think that lumping the two, while we are similar at businesses, we don't think that we are aligned in the same way the engineering firms are. We think that engineering is truly a different type of practice. Much more of the revenue that goes to engineering firms, we often see, stays with those engineering firms. Almost 50 percent of our revenue passes through our firm and goes to engineering firms. So for that reason we think that categorizing us both together would be a big mistake.

Ms. CHU. And just for the panel, we have heard from witnesses that certain size standards are either too high or other size standards are too unrealistically low. How do we find the balance between allowing those slightly larger firms to compete for contracts while protecting the ability of smaller businesses to gain access to the market?

Mr. CHARLES. I think one of the ways is actually to—I heard the idea earlier, Mr. Jordan proposed it—the idea of having different size standards for procurement, restricting competition, as opposed to SBA assistance. I think there is real validity in looking at that, and I believe that the Federal Procurement Data Systems data would inform what the size standard should be, separating the dominant from the nondominant, in this particular market.

Mr. JORDAN. I would just add to that. The key phrase there: Separating the dominant from the nondominant. And right now, when I look at where we are with computer-related size standards, there are clearly nondominant firms that would not be included in the definition of a small business today.

And I am not suggesting that our size standards should be raised by tens of thousands, tens of millions of dollars. We have this ongoing debate even within our own companies about what a midsize firm is, and it ranges from anywhere from \$25.5 million and above up to a billion. And it really comes down to where you sit is where you stand in terms of your position on size standards.

So I think it is a big, big challenge, but certainly one that needs to be explored further. And I think that, again, by focusing more on what the Federal contracting market looks like, you can begin to get a better sense of what a small business contractor should look like.

Mr. FONTANA. I think it is market driven and it is industry and subindustry driven as well. I agree that using FPDS and other sources to look at that and understand that subindustry is very important; doesn't make it any less challenging or any less daunting.

But looking at the business side of it to see what are the business models, the organizational models of the companies in that industry or subindustry are important, because that, along with looking at the available data, or any other data that could be obtained, would give a good indication of what the size standard should be, whether it should be employee based, revenue based, or a combination of both.

Ms. CHU. Thank you. I yield back.

Chairman HANNA. Thank you.

Mrs. Lawrence.

Mrs. LAWRENCE. Thank you.

Thank you, gentlemen, for being here today.

Michigan has over 850,000 small businesses, so it goes without saying that small businesses are the backbone of our economy, making that much more important that we succeed.

Mr. Fontana, let's say a small business owner in Detroit wants to challenge an established or revised size standard by SBA. It is my understanding that the only avenue for the small business owner is to file a Federal lawsuit against the government. Is that correct?

Mr. FONTANA. Yes, ma'am, that is correct. That is as opposed to a particular NAICS designation on an individual procurement. But that is correct, they would have to go to Federal court.

Mrs. LAWRENCE. I want for the record, please, if you could explain the time line and the costs associated with a small business owner trying to make this appeal.

Mr. FONTANA. Or any business owner. And don't hold me to the numbers, because each case is always different.

In mounting an APA, Administrative Procedure Act, claim against the government, it would have to be filed in Federal district court, and I will just dispense with really the court fees and other related costs. That can be anywhere from, if it is very short where you get it to a summary judgment stage or you get it to a higher stage where there are more briefs or more motions and more delays, it can be anywhere from \$50,000 to \$100,000 or more.

Typically, they are not jury issues unless there are disputed facts, and typically here that is not the case. But it is still, for small businesses, a very, very expensive proposition.

Some small businesses in the VARC that I represent, 13 companies, they have pooled resources in some cases, but it is a little less common that their interests will be totally aligned in that kind of challenge. So they would be more apt to do individual lawsuits, and then each small business would have to pay that individual expense.

Mrs. LAWRENCE. What is the time line?

Mr. FONTANA. The time line for something like this, it is usually several months. It could be up to or over a year, depending on the court docket, depending on the amount of evidence, or depending on the amount of hearings that would be held. And discovery is another big issue where I call it the long pole in the tent in litigation. Discovery itself could take a year or more.

Mrs. LAWRENCE. So your recommendation to fix this would be?

Mr. FONTANA. Well, the Stronger Voice Act is a good start. For one, allowing small businesses like in size and status protests, to use that administrative forum and that administrative remedy, still have the availability of judicial review as this bill has. But allowing that to go before the SBA and the SBA Office of Hearings and Appeals is a start.

Another avenue, and it is the other way to look at it, as the Subcommittee is, is to counsel the SBA or compel the SBA through legislation to follow the standards that this Congress has mandated.

Mrs. LAWRENCE. Thank you.

Mrs. LAWRENCE. Mr. Charles, I have a few minutes. I want to ask this question. Michigan is home to very large numbers of engi-

neers in comparison to anywhere else in the world, so we have a lot of technology companies and startups.

How would this proposed new rule have an impact on technology manufacturing or the technology service providers? Do you have a sense of the impact it would have? And I am concerned about that because in Michigan that is one of our driving economies.

Mr. CHARLES. So are we talking about the proposal to eliminate Footnote 18? Is that the rule we are talking about?

Mrs. LAWRENCE. We are talking about the ability for these entrepreneur startup incubators to provide opportunities for small businesses going there. Will that impact it, the legislation that you are speaking of?

Mr. CHARLES. I am sorry. I am not familiar with the rule you are referring to.

Mrs. LAWRENCE. Okay. The new law, the new rule that we are proposing to correct or make sure that the SBA is in compliance, will that have an impact on startups?

Mr. CHARLES. So we are talking about the Stronger Voice?

Mrs. LAWRENCE. Yes. Yes.

Mr. CHARLES. Okay. So I believe it is really important for truly small businesses to make sure that the government understands what they do, how their business works within the NAICS code structure, and that the government customers are requesting the proper NAICS code for what it is they expect to be happening under the contemplated contract action.

I believe I am very much in support of the Stronger Voice Act. My concern, generally, about new technology companies is that the NAICS code structure itself is perpetually a decade old. And that is the root of the problem, in my opinion.

Mrs. LAWRENCE. That is where I was trying to go. Thank you.

Chairman HANNA. Thank you.

If the Committee doesn't mind, we can open this up to another round or anybody who wants to ask a second question can. Does anyone mind if I do?

Mr. TAKAI. No, Mr. Chairman.

Chairman HANNA. Okay. Thank you.

You have all been through the process with the SBA. How receptive are they without going through hell?

Mr. FONTANA. Of course, you would have to describe hell in this.

Chairman HANNA. Sure.

Mr. FONTANA. It varies. I have dealt with the SBA on more than several occasions, and I have had the privilege to deal with a number of Federal agencies over 30 years of being in this practice.

There are times that the SBA is very accommodating. After the comment period ended for this rule, they did entertain a meeting with representatives of the VARC, the small IT-VARS that we represent. Now, it took quite a bit to get them in a room, but they did. I have had conversations with their general counsel's office on this.

And so it is not that they have not been willing to discuss. The issue is, are they willing to listen? And that is the key issue, are they willing to listen to the realities of this particular subindustry and understand that they have to use and analyze the correct data in making these rulemakings relative to size standards? If that is the case, they are not.

Chairman HANNA. Does that mirror your experience, Mr. Charles, Mr. Reim?

Mr. CHARLES. I have had good relationships with SBA. They take meetings and are happy to discuss things. I find that they often are not familiar with the downstream consequences of their rule-making, and it is why I continue to repeat my interest in having more thorough analysis of procurement data at the line-item level be part of this process, because when I bring these things up, they are not knowledgeable.

Chairman HANNA. Mr. Reim?

Mr. REIM. I would concur. The subject of our increase, for example, and our NAICS code growing has been proposed several times, and it doesn't seem to reflect the reality of our business. So I wonder if they have really dug into it and tried to understand it sometimes.

Mr. JORDAN. I would agree with Mr. Fontana. They have been open to sitting down and having a dialogue, but I haven't seen them be willing to make a whole lot of changes. Their methodology is what it is. I don't see them going back and reviewing that and making changes to it, and I don't think they are paying a whole lot of attention to the Federal contracting dynamics.

So when we raised those concerns, we raised them both in our comments to the methodology, we raised those concerns when we commented on the proposed rules. And even though they were willing to come down and sit and talk with us, it feels like our comments fell on deaf ears.

Chairman HANNA. So it is atrophy and a war of attrition, perhaps.

The interesting thing, Mr. Reim, is that in your business you would like to have the size standard smaller. Ninety-five percent of all architects fit under the standard that is existing, \$7.5 million.

And in your case, Mr. Charles and other people, it is kind of the opposite. The relationship between revenue and employee is completely different. So you need to have a different standard.

I want to thank everybody.

Anybody else would like to ask another question?

Mrs. LAWRENCE. No.

Mr. TAKAI. No.

Chairman HANNA. We are pushing up against votes any second here, so if there are no further questions for these witnesses, I want to thank all of you for your testimony. Getting the size standards right is one of the most important jobs the SBA has, and it is shameful that they are not faithfully executing the laws.

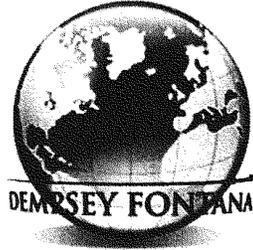
I want to thank you, Mr. Bost, for your legislation, 1429, which would at least provide a check for the SBA and an opportunity to appeal.

This issue is important to this Subcommittee, and we will continue to monitor it.

I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

Chairman HANNA. This hearing is now adjourned. Thank you all. [Whereupon, at 11:12 a.m., the Subcommittee was adjourned.]

**A P P E N D I X**



**STATEMENT OF JAMES C. FONTANA, ESQ.**  
MANAGING MEMBER, DEMPSEY FONTANA, PLLC

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

JUNE 4, 2015

Chairman Hanna, Ranking Member Takai, and members of the Subcommittee, my name is James Fontana, and I am a founding member of the Dempsey Fontana law firm which is located in Reston, Virginia. For over 30 years my law practice has focused almost exclusively on government contracts. During that time I have served as an attorney in both major law firms to include Reed Smith and Kominers Fort, and as a general counsel for some of the most recognizable government contractors such as BDM, Wang Federal and Apptis Holdings. Our law firm's practice is focused particularly on the business and legal issues faced by small government contractors and in that respect we represent a good number of Information Technology Value Added Resellers or ITVARs. I thank you for the opportunity to testify today to discuss the continuing challenges of those small companies doing business with the federal Government.<sup>1</sup>

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<sup>1</sup> In preparing this Statement, I gratefully acknowledge the valuable assistance of my partner, David B. Dempsey.

Today I am testifying on behalf of 13 small IT-VARs that have formed an ad hoc coalition called the Value-Added Reseller Coalition, better known as “VARC”. These companies, which are representative of thousands of other similarly situated IT-VARs around the nation, compete on individual agency small business set-aside solicitations or multi-billion dollar agency program requirements “reserved” only for small businesses. The VARC members fall under various SBA programs including Small Disadvantaged Businesses, Women-Owned small businesses Service-Disabled Veteran-Owned Small Businesses (“SDVOSB”), and small businesses that are located in what are known as HUBZones.

On behalf of the VARC and I am sure many other small IT-VARs, I am sharing my concerns with regard to the actions of the Small Business Administration (“SBA”) in promulgating proposed regulations in a way that is inconsistent with applicable legal standards, and in particular the SBA’s September 2014 proposed rulemaking that I believe was ill-conceived from a legal, logical and common sense standpoint, and which proposed regulations, if finalized, will have a devastating impact on many small government contracting businesses to include the VARC members, as explained in more detail below. In making this statement I emphasize that I have the greatest respect for Executive Branch agencies and I have had the privilege of working with many federal agencies, to include the SBA, during my many years as a government contracts lawyer.

Also today I am expressing my support for H.R. 1429, the Stronger Voice for Small Business Act of 2015 (the “Act”). The underpinnings of my support are twofold: First, businesses selling goods and services to the Government that are certified as “small” under regulations promulgated by the SBA face increasing regulation of their business and in particular are subject to the SBA’s changing size standards. As you are aware, the Small Business Jobs Act of 2010 (the “Jobs Act”) directs the SBA conduct a detailed review of all size standards every five years and to make appropriate adjustments to reflect market conditions.<sup>2</sup> The only avenue for these small companies to challenge a size standard established, revised or modified by the SBA is for such companies to file a federal lawsuit against the Government pursuant to the Administrative Procedure Act (the “APA”).<sup>3</sup>

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<sup>2</sup> See Pub. L. No. 111–240 § 1344, 124 Stat. 2504, 2545 (Sept. 27, 2010). More specifically, the Jobs Act requires SBA to conduct a detailed review of at least one-third of all size standards during every 18-month period from the date of its enactment. The Jobs Act requires further that the SBA review all size standards not less frequently than once every five years thereafter. Reviewing existing small business size standards and making appropriate adjustments based on the latest available data are also consistent with Executive Order 13563 on improving regulation and regulatory review. As noted below, additional requirements for SBA size standards were enacted under the National Defense Authorization Act of 2013 (“2013 NDAA”).

<sup>3</sup> 5 U.S.C. §§ 500 *et seq.* Judicial review of an agency’s proposed rulemaking is available under the APA if a plaintiff is “adversely affected or aggrieved” by any final agency action “within the meaning” of the statute at issue. 5 U.S.C. § 702. We note that the Proposed Rule as published in September 2014 reflected the revenue-based size standard of \$25.5 million and the SBA’s October 20 publication properly corrected that this standard is currently \$27.5 million. It appears, however, that the SBA based its so-called market analysis on the \$25.5 million revenue

This Act will allow small firms a quicker and much less expensive administrative forum to challenge such size standards. Petitions before the SBA's Office of Hearings and Appeals ("OHA"), much like the similar process used to file protests of a contractor's size or other status and the OHA appeal process for the SBA's decisions on such protests, are relatively short and simple, as opposed to the mounds of pleadings, motions, discovery and hearing-related documents that are required to be filed to initiate and maintain an action before a federal district court. Small businesses typically lack the resources to file such expensive lawsuits to challenge SBA rulemaking actions which may later prove to be arbitrary, capricious and otherwise not in accordance with applicable laws. Under this Act, small companies will be afforded a way to pursue such legitimate challenges before the OHA without going through the expense of a full-blown and protracted lawsuit.

Second, the administrative forum created by the Act is particularly needed at this time given the SBA's recent proposed deletion of the 150 employee-based size standard contained under North American Industry Classification System ("NAICS") Code 541519, Note 18. On September 10, 2014, the SBA published a proposed rule that would remove the Information Technology Value Added Resellers ("ITVAR") Sub-Industry exception under NAICS Code 541519. This exception contains the 150 employee-based size standard under Note 18 of that NAICS Code and, if eliminated, would leave only the \$27.5 million revenue-based size standard.<sup>4</sup> The SBA had recently stated to me in a meeting on March 24, 2015 that it expects to finalize the Proposed Rule sometime this summer.<sup>5</sup>

There are a number of reasons why the Proposed Rule should not be implemented and represents a valid backdrop for the Act. Indeed, the Act would afford small businesses, to include ITVARs, the opportunity to correct the inexplicable policy error resulting from the Proposed Rule from a legal, economic, judgmental and common sense standpoint. As explained in more detail below, the Proposed Rule is **not** supported by relevant data and is completely contrary to the SBA's prior exhaustive analysis performed in 2002-2003 (and reaffirmed in March 2011), which established the 150 employee-based size standard as **the** proper one under Note 18. The

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standard. Although in this Statement along with our comments to the SBA we used the higher standard, the analysis and conclusions provided here do not change appreciably.

<sup>4</sup> See Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, 79 Fed. Reg. 53646 (Sept. 10, 2014), as amended in 79 Fed. Reg. 62576 (Oct. 20, 2014) (the "Proposed Rule").

<sup>5</sup> This firm, along with about 170 other companies, individuals and organizations, filed comments in response to the Proposed Rule. An overwhelming majority of those comments, as with our comments, were opposed to the SBA's proposed elimination of the Note 18 exception. We also appreciate the letter sent to the SBA by then Chairman Graves, dated November 10, 2014, in opposition to the Proposed Rule. Although there is opposition to other parts of the Proposed Rule's changes to various NAICS codes, our focus here is on NAICS 541519, Note 18. Our office continues to correspond with the SBA to provide input with regard to the Proposed Rule with respect to the Note 18 exception.

Proposed Rule would also have a devastating impact on many small businesses now providing information technology (“IT”) products and services to the Government as they will be ineligible to receive set-asides, and it will significantly curtail the Government’s ability to count on a reliable small business industrial base to provide these products and services. More importantly, the Proposed Rule violates the explicit legal standards enacted by the Congress.

#### A. Background

The Proposed Rule is a perfect example of why the Act should be enacted by Congress. ITVARs sell IT products (hardware and software), solutions and related services to the U.S. Government under NAICS 541519, Note 18. These companies compete on individual agency small business set-aside solicitations or multi-billion dollar agency program requirements “reserved” only for small businesses.<sup>6</sup> Such companies fall under various SBA programs including small disadvantaged businesses, women-owned small businesses (“WOSB”), service-disabled veteran-owned small businesses (“SDVOSB”), and small businesses that are located in historically underutilized business zones (“HUBZones”). These types of small business ITVARs are awardees who benefitted through the “reserve” portion of such multi-billion dollar agency acquisition programs as the Department of Homeland Security’s (“DHS”) First Source II, and NASA’s SEWP V as well as other Government-Wide Acquisition Contracts (“GWAC”), individual contracts and task and delivery orders that rely on Note 18’s exception to the revenue-based size standard (currently \$27.5 million) for NAICS Code 541519.

Small ITVARs seeking their fair proportion of Government small business set-aside awards rely heavily on NAICS Code 541519, Note 18, as do procuring agencies that are required by federal statute to award at least 23 percent of all prime Government contract dollars to small businesses. The SBA’s proposed change to NAICS 541519 to a receipts-based only size standard would greatly impact the small companies that depend upon those contracts to grow organically. By eliminating the 150-employee size standard exception to the NAICS Code 541519 receipts-based size standard contained in Note 18,<sup>7</sup> the Proposed Rule would *exclude* any otherwise “Note 18” small ITVAR business with annual receipts in excess of \$27.5 million from pursuing small business set-aside opportunities currently available to them. Many, if not most, small ITVARs easily exceed the \$27.5 million receipts threshold because the ITVAR business model (of which the federal agencies readily avail themselves to meet their annual small business contracting

<sup>6</sup> “Reserve” set-asides are particularly well-suited for the small business IT industry and federal agency procurement offices because these reserved set-asides allow contracting officers to obtain the well-acknowledged IT expertise of small companies. The SBA appears to have completely ignored the “reserve” procurement method made available through the IDIQ, multiple award contract vehicle. The irony is that such reserves came about from §1331 of the Jobs Act (see 77 Fed. Reg. 29130, 29139-41 (May 16, 2012)(proposed rule); 78 Fed. Reg. 61114, 61134-35 (Oct. 2, 2013), and the SBA’s Proposed Rule would have the effect of eliminating jobs for many ITVARs.

<sup>7</sup> “Receipts” is defined as “total income” (or in the case of a sole proprietorship, “gross income”) plus “cost of goods sold” as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms.” 13 C.F.R. § 121.104(a).

goals) requires a high volume of product sales (*i.e.*, “cost of goods sold”) due to the low profit margins in this highly competitive industry. Thus, although annual receipts of an ITVAR appear high, these receipts do not reflect an ITVAR’s profits because such the dollar value of an ITVAR’s receipts are based almost exclusively on the volume of IT-related products which is a pass-through cost and not reflective of the associated value-added services provided to the Government. This makes the \$27.5 million receipts-based size standard a less accurate, and indeed on balance an improper, measure of the true size of the small ITVAR. Note 18’s employee based standard is, therefore, critical to ITVARs because these companies have a very small number of employees in relation to their revenue stream, especially when compared to companies which provide mostly IT services.

**B. The SBA’s Analysis is Based Upon Non-Existent, Incomplete or Inapplicable Data**

The SBA’s basis for the elimination of the ITVAR 150-employee size standard is unsupported by the data cited in the Proposed Rule. For example, the SBA states:

SBA’s analysis of 2007 Economic Census data shows that 150 employees is more or less equivalent to [\$27.5] million receipts in NAICS 541519 and that more than 99 percent of firms below the 150-employee level will continue to qualify as small under the [\$27.5] million receipts based size standard. Thus, the proposed elimination of the ITVAR sub-industry category and its 150-employee size standard, if adopted, will have very minimal impact on businesses below 150 employees.

Proposed Rule at 53656.<sup>8</sup>

Not only does the SBA completely ignore the pass-through costs/receipts of IT hardware, but it is almost incomprehensible how the SBA could have reached its “minimal impact” conclusion regarding the continued qualification of 99 percent of ITVAR firms on “2007 Economic Census data.” The SBA acknowledged elsewhere in the Proposed Rule that “the data from the Census Bureau’s tabulation are limited to the 6-digit NAICS industry code and hence *do not provide economic characteristics at the sub-industry level ... (that is, one of the exceptions).*” Proposed Rule at 53651 (emphasis added). In other words, the SBA clearly admits that the Economic Census Data (for any year) does not in fact provide the economic basis which the SBA employs to justify the elimination of the specific “sub-industry” that was established in 2002. Given that the 150 employee standard is an exception to NAICS code 541519 receipts-based size standard, the SBA’s statement that it relied on 2007 Economic Census data is ludicrous because the

<sup>8</sup> We note that SBA based its analysis on the 2007 Economic Census tabulation, which the SBA claims is the “latest available.” See Proposed Rule at 53649. The SBA, however, appears to have ignored that their data is (1) seven years old and (2) does not contain any information about the companies that actually received contract awards based on the 150 employee-based exception under Note 18. *Id.* Thus, by SBA’s own admission, it has no knowledge of what or how many small ITVARs received awards based on Note 18 (150 employees) versus the receipts-based qualification for NAICS Code 541519.

economic data that the SBA used is related solely to IT services companies and not for ITVARs that provide services and hardware and software. In effect, SBA is arbitrarily using apples to eliminate oranges. We believe that the SBA needs to review the data that we reviewed – that is, actual procurement data that could be made available to the SBA from the procuring agencies if not from available public sources. Absent such a proper analysis of this data along with other available market data that the SBA is required to consider under the Jobs Act and the more recent 2013 NDAA, ITVARs, like other small businesses, should have an alternative forum to challenge the Proposed Rule along the lines afforded by the Act.

It appears that the SBA concedes there is no “economic” data to support its conclusion that more than 99 percent of the firms below the 150 employee level will continue to qualify as small businesses under the NAICS code 541519 receipts-based qualification. In other words, SBA acknowledges that the data used to justify its Proposed Rule is inapplicable. The problem with the SBA’s reliance is underscored by the data in **Attachment A** which clearly demonstrate that 150 employees is not even remotely equivalent to \$27.5M in annual receipts for a small business ITVAR. Many small ITVARs have annual receipts exceeding \$27.5M, while employing substantially fewer than 150 employees. Indeed, the only VARC member with somewhat comparable annual receipts (approximately \$30M) has only 25 employees, or less than a sixth of what the SBA assumed to be the case.

**C. The Data Provided in Attachment A Directly Contradicts the SBA’s Conclusions**

Significantly, virtually all of the ITVAR companies that this law firm represents to include the VARC members would become instantly ineligible for small business set-asides or reserves under the Proposed Rule because the annual receipts of these 12 companies exceed \$27.5 million but have fewer than 150 employees.<sup>9</sup> Also, and as discussed further below, our own data contained in **Attachment A** to this Statement establishes that numerous other currently small ITVARs will also instantly become large businesses if the Note 18 exception is eliminated as proposed.<sup>10</sup>

Contrary to the SBA’s admittedly inapplicable “economic data,” the majority of the small ITVARs that we reviewed will lose their small business size status under this NAICS Code if the 150 employee based size standard is eliminated because their annual receipts (averaged over a three year period) exceed \$27.5 million. Using relatively straightforward survey of ITVARs that

<sup>9</sup> Twelve of our VARC members have annual receipts exceeding \$27.5 million but have fewer than 150 employees. Indeed, all of the VARC members have average annual receipts of nearly \$123 million but only an average of 50 employees.

<sup>10</sup> Please note that the data provided in **Attachment A** was also provided to the SBA in our comments in opposition to the Proposed Rule, although updated for the Subcommittee to reflect recent additional contract awards. We intend to provide the revised data to the SBA as well. See note 11, *infra*.

received awards under some of the largest “Note 18” reserved GWAC shows that SBA’s attempted correlation of receipts to employees is simply wrong when applied to the IT community. In particular, many “Note 18” small ITVARs (and certainly *not* merely 1 out of 100) will lose their size status under NAICS Code 541519 upon the elimination of Note 18’s 150 employee-based standard.

Our conclusion with regard to the faulty SBA data is supported by data that we have obtained from publically available federal agency websites, the Federal Procurement Data System (“FPDS”) website and the USASpending.gov website. **Attachment A** to this Statement lists those small businesses awarded contracts under DHS First Source II (“FSII”), U.S. Air Force Netcentric 2 Products (“NETCENTS-2”), NASA Solutions for Enterprise-Wide Procurement V (“SEWP V”) and U.S. Department of Health and Human Services, National Institutes of Health (“NIH”) Chief Information Officer – Commodities and Solutions (“CIO-CS”) procurements – all “reserved” acquisition programs per the Jobs Act.

As reflected in **Attachment A**, the publicly available data shows that 17 small ITVAR awardees under the DHS FSII contract have under 150 employees and annual receipts above \$27.5 million, accounting for 63 percent of the total number of small business FSII small business awardees. With respect to the Air Force NETCENTS-2 small business reserved contract awards, 7 small ITVARs have under 150 employees and have annual receipts above \$27.5 million, accounting for 64 percent of the total number of small business NETCENTS-2 awardees. Under the NASA SEWP V contract, 43 small ITVARs have under 150 employees and have annual receipts above \$27.5 million, accounting for 41 percent of the total number of small business SEWP awardees. Under the NIH CIO-CS contract, 27 small ITVARs have under 150 employees and have annual receipts above \$27.5 million, accounting for 67.5 percent of the total number of small business CIO-CS awardees. All of these businesses, or a total average of **43 percent** of the total number of awardees that are currently qualified as small under NAICS Code 541519, Note 18, will not qualify as small under the Proposed Rule.<sup>11</sup> We emphasize that our data is based on the awardees and does not include the hundreds of other small ITVARs that submitted offers for each agency’s small business reserved acquisition.<sup>12</sup>

<sup>11</sup> The original data in **Attachment A** that was supplied to the SBA in November reflected that 51% of the small ITVARs would lose their size status under the Proposed Rule. However, some of this data has since changed. For example, SEWP V added a significant number of new small ITVAR awardees after various bid protests were filed and NASA took corrective action leading to these additional awards. In addition, the CIO-CS contract was awarded which added an additional contract vehicle to this list. Although the total percentage of adversely impacted ITVARs has since fallen to 43 percent (primarily due to the changes in the SEWP awardees), this percentage is still significantly higher than the 1 percent of the ITVARs that the SBA concluded would be adversely affected by the Proposed Rule.

<sup>12</sup> Federal agencies use these large IDIQ contract vehicles to procure billions of dollars of hardware, software and related services from both large and small ITVARs. The publicly available information from these *actual* contract awards show many such awards are made to small ITVARs with less than 150 employees and more than \$27.5 million in annual receipts. Agencies will almost certainly reduce, if not cease, making awards under these contracts

Thus, even a cursory look at publically available data illustrates the certainty that many more than 1 percent of the firms will lose their small business status under NAICS Code 541519 if Note 18 is eliminated as proposed. In addition, our data shows that virtually all of these companies with receipts above \$27.5 have substantially fewer than 150 employees.<sup>13</sup> Put another way, with regard to the companies listed in **Attachment A**, where actual data exists, the average dollar amount of annual receipts is approximately \$41,790,715 and the average number of employees is 38. This data is completely contradictory to the SBA's conclusion that an ITVAR with "150 employees is more or less equivalent" to a firm with \$27.5 (or even \$25.5) million in revenue. Proposed Rule at 53656. The available data reflects that such receipts are, on average, much higher for this employee headcount.

We respectfully conclude that the SBA has no actual or even anecdotal data to support its statement that 99 percent or even a majority of small ITVARs will continue to be small using only the receipts-based standard under NAICS 541519. The SBA's lack of data and the existence of data contradicting the SBA's basis for the Proposed Rule is the very reason not to change the exception to NAICS Code 541519 provided by Note 18. We note that SBA should obtain a list of offerors for each agency's procurements conducted under NAICS code 541519, Note 18 and then use the data from the FPDS and USASpending websites to identify the actual annual receipts and the number of employees – as we did in **Attachment A**. Following that exercise, the SBA can much more accurately estimate the number of small ITVARs that will no longer qualify as small businesses if the Proposed Rule is adopted. We also encourage the SBA to learn what ITVARs actually do for federal agencies because if the SBA had known and understood the difference between an IT services company versus an ITVAR, we believe that the SBA would not have proposed the elimination of Note 18.

In short, the SBA failed to provide relevant (**much less actual**) market data or adequate justification for removing Note 18 from NAICS 541519. On the contrary, SBA's proposed change to NAICS 541519 would only succeed in harming small ITVARs and will greatly impede the ability of federal agencies to fulfill their programs that now set aside billions of dollars for small business concerns meeting the current 150-employee size standard.

**D. The SBA Has Failed to Justify its Departure from the Already Established Employee Standard**

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to small ITVARs in the future in the Proposed Rule is adopted because agencies will no longer receive small business goal credit for such small business set aside awards.

<sup>13</sup> We acknowledge that the FPDS data may not necessarily reflect a three-year average of annual receipts; however, a good number of our clients are listed as awardees under the SEWP V and First Source II contracts and their three year average receipts are definitely consistent with the FPDS-generated data shown in **Attachment A** and notes thereto. We acknowledge the somewhat incomplete nature of our data, but such numbers clearly indicate that the SBA's conclusions and the reason for its conclusion with regard to the average number of employees of an ITVAR with \$27.5 million in revenue as well as the "minimal" impact of the Proposed Rule are completely incorrect.

The SBA was unequivocal in 2002 and 2003 in explaining that an employee-based size standard was the most rational and fair standard for ITVARs. In that notice of proposed rulemaking, SBA made it clear that: “In recognition that a substantial amount of the dollar value of the contract will be for hardware and software sales, ***an employee size standard is considered an appropriate size standard*** to measure the magnitude of operations of IT Value Added Resellers.” See Small Business Size Standards; Information Technology Value Added Reseller, 67 Fed. Reg. 48419, 48420 (July 24, 2002) (emphasis added) (the “2002 Proposed Rule”). In the final rule that was published in 2003, the SBA similarly stated that

Based on a review of ITVAR industry characteristics, the SBA is adopting a 150 employee size standard, which it believes more sufficiently considers the overall characteristics of the types of firms engage [sic] in ITVAR activities. . . . ***An employee size standard is considered a better measure of the size of ITVARs operation than receipts since a substantial proportion of their receipts merely reflect the dollar value of equipment and software sold.***

68 Fed. Reg. 74833 at 74834 (emphasis added). The SBA based this conclusion on a detailed, quantitative analysis of data concerning ITVARs, including the average firm size, the distribution of firms by size, startup costs, industry competition, the impact of size standard revision on the SBA programs, and its analysis of public comments. 68 Fed. Reg. 74833 at 74837-39. No such analysis was provided in the Proposed Rule. Indeed, as recently as 2011, the SBA continued to believe that a 150-employee based standard was the most appropriate. See Small Business Size Standards: Professional, Scientific and Technical Services, 76 Fed. Reg. 14323, 14333 (Mar. 16, 2011) (“In this proposed rule, the SBA proposes to retain the current 150 employee size standard for ITVAR.”). Thus, the SBA has long recognized that receipts are not an accurate measure of the size of a small ITVAR and that the number of employees is more accurate.

It is well-settled that “an agency changing course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first place.” *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 42 (1983); see also *Atchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. of Trade*, 412 U.S. 800, 808 (1973) (an agency has a duty to “explain its departure from prior norms”). The Proposed Rule does not contain the requisite analysis to justify reversing course on the Note 18 150-employee based standard.

There is no reason -- nor does the SBA provide any reason -- to suggest why the explanation and rationale provided in 2002 and 2003 (and continued in 2011) no longer applies today. The Proposed Rule makes no comparison with the 2002, 2003 or 2011 rulemaking analyses and provides no facts or reasons regarding changes in the ITVAR industry and the federal IT procurement marketplace that justifies the SBA’s complete about face on the employee size

standard articulated in Note 18. In fact, nothing has changed and the SBA has not provided a single reason that addresses much less adequately explains why an employee size standard is no longer a “better measure” of the size of an ITVAR operation or why the elimination of this size standard is in any way warranted.

The SBA’s sole justification in the Proposed Rule for rescinding the employee based size standard is that it has “created some inconsistencies, confusion and misuse.” Every example cited by SBA, however, is vague, conjectural and speculative. In its first example, SBA asserts that “the public often believes” that a firm that received an award under NAICS 541519, Note 18 is not actually small based on its annual receipts because contracting officers cannot identify size standard exceptions in Federal Procurement Data System – Next Generation (“FPDS-NG”). Proposed Rule at 53656. This alleged “confusion” is entirely speculative and predictably the SBA provides no data, examples or other details that support the existence of “public confusion.” Therefore, SBA’s conclusory statement cannot possibly justify or otherwise rationalize the complete demolition of the Note 18 exception. To the extent such confusion does exist, it would suggest that FPDS-NG should be modified to include a data point for Note 18 as opposed to eliminating this particular exception.<sup>14</sup> Put another way, the SBA should not arbitrarily throw the baby out with the bath water in promulgating rules that have a significant impact on the small business community. Even still, as noted above, a compilation of other data available from FPDS provides more than a sufficient basis to conclude that elimination of Note 18 would result in many small business firms becoming ineligible under NAICS Code 541519 in the future.

Moreover, the SBA states that there are “many cases where Federal agencies have applied the 150-employee size standard, instead of the receipts based size standard” and that this “*may have* benefited more successful, mid-size companies at the expense of those below the receipts based size standard.” *Id.* Emphasis supplied. The fact that SBA does not and cannot know for certain whether “more successful, mid-size companies” are benefiting is telling of the lack of analysis

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<sup>14</sup> The SBA has correctly pointed out that it is both difficult to determine compliance with the Note 18 standards under NAICS 541510 and that there may have been certain abuses to that standard, or at least that some ITVARs and procuring agencies have not fully monitored such compliance, especially with regard to the requirement under Note 18 that the ITVAR provide at least 15 percent and no more than 50 percent of the value added services. We believe that the SBA has not fully appreciated the business and organizational models of the ITVAR both from a pre-sales, sales and engineering standpoint as well as the service delivery aspects of this business. An ITVAR will provide a vast number of pre-award and post-award services that are required to successfully execute a solution on any given Government contract or task order. We understand that at least one procuring agency has offered to develop for the SBA written guidance regarding the proper implementation of the Note 18 exception, and such guidance is also included directly within the CIO-CS contract. To the extent any inconsistencies, confusion or misuse actually exists with regard to the proper application of the Note 18 exception, we submit that this type of guidance would address the SBA’s concerns and eliminate or greatly mitigate such inconsistencies, confusion or misuse.

supporting the Proposed Rule.<sup>15</sup> The SBA's conjecture here falls far short of the reasoned analysis necessary to justify its rescission of its prior rule.

One of the many benefits that ITVARs currently bring to the Government is their ability to offer a comprehensive catalogue of products along with their value enhancing services, including network infrastructure and security assessments, training, project management, network consolidation and virtualization deployments, hardware/software installation/integration, help desk support and maintenance. Eliminating the employee based size standard here will eliminate significant depth to the products and services the Government currently receives from small ITVARs pursuant to this NAICS Code.

**E. The SBA's Alternative to Note 18 Is Illogical and Will Cause Undue Competitive Harm to the Small ITVAR**

The Proposed Rule observes that, "instead of using the ITVAR 150-employee size standard under NAICS 541519, a contracting officer could use a manufacturing NAICS code and size standard, such as NAICS 334111 (Electronic Computer Manufacturing) with 1,000-employee size standard, to which the non-manufacturer size standard of 500 employees would also apply." Proposed Rule, at 53656. This is a problematic and illogical approach. To begin with, the fact that an alternative purchasing method exists does not justify eliminating a well-established NAICS size exception. In addition (and as the SBA stated in 2002 and 2003), NAICS Code 541519, Note 18 is unique for the ITVAR community and its virtual elimination would create an undue burden for the small ITVARs by forcing them to compete in various manufacturing NAICS that are not designed for the supply sector of the federal IT industry, which is dominated by much larger companies. Moreover, the various manufacturing NAICS Codes do not include the above-mentioned value added services that ITVARs offer in connection with its product sales. More importantly, the procuring agencies are seeking to benefit from the ITVAR's expertise, experience and knowledge -- not simply desktops and laptops -- but integrated systems and IT planning which is implemented to one degree or another by the agency's purchase of the appropriate IT products and services.

Finally, resorting to a manufacturing NAICS code forces small ITVARs to meet a restrictive standard under the SBA's non-manufacturing rule ("NMR") unless there is a class waiver issued by the SBA or an individual waiver of the NMR issued by the contracting officer (for the specific procurement action) and approved by the SBA.<sup>16</sup> This waiver process is highly cumbersome and in some cases such waivers are difficult to obtain in a timely fashion even if the

<sup>15</sup> We also fault the SBA's logic regarding its reference to "many cases." That is, the only reason such "mid-size companies" become "mid-size" in the SBA's logic is because the SBA applies the consequences of its Proposed Rule to past circumstances. It appears, however, that the SBA does not know and has made no effort to learn such facts.

<sup>16</sup> The SBA's regulations allow small businesses to avoid this requirement only if it receives either an individual waiver by a contracting officer or a class waiver from the SBA. Id. § 406 (b)(5), (6).

circumstances justify a class waiver or the contracting officer has valid justification for an individual waiver.<sup>17</sup> Additionally, the NMR would significantly limit the number of product offerings a small business could offer to the Government because realistically either individual NMR waivers issued by a contracting officer for SBA approval or class waivers issued by the SBA are not always available and at the very least tend to delay important procurements. While there are certainly many great IT products made by small businesses, agencies will not get the benefit they seek from ITVARs if the ITVAR can only offer a fraction of the products available on the market. Thus, at the very least, the NMR restricts the small ITVAR from providing the full spectrum of desired products to agencies and causes delays in the procurement process.

**F. The SBA Failed to Follow the Jobs Act and 2013 NDAA Requirements in Issuing the Proposed Rule**

We appreciate that, as part of its comprehensive size standards review required by the Jobs Act, the SBA must evaluate employee-based size standards for all 364 industries in the various applicable NAICS sectors to determine whether they should be retained or revised, and the SBA has professed in the Proposed Rule that it was responding to the Jobs Act's requirements. Having said that, and as stated above, Section 1344 of the Jobs Act is very clear on the requirement that the SBA "make appropriate adjustments to the size standards . . . to reflect market conditions." More recently, Section 1661 of the 2013 NDAA amended Section 3 of the Small Business Act to allow common size standards among related industries only if the SBA finds that the common size standard is appropriate for each industry independently. The amendment also prohibits the SBA from limiting the number of size standards, and requires that the SBA assign the appropriate size standard to each NAICS. Significantly, this provision further requires the SBA to consider, in its proposed rulemaking with regard to size standards,

- (A) a detailed description of the industry for which the new size standard is proposed;
- (B) an analysis of the competitive environment for that industry;
- (C) the approach the Administrator used to develop the proposed standard including the source of all data used to develop the proposed rulemaking; and
- (D) the anticipated effect of the proposed rulemaking on the industry, including the number of concerns not currently considered small that would be considered small under the proposed rulemaking and the number of concerns currently considered small that would be deemed other than small under the proposed rulemaking.

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<sup>17</sup> The difficulty of obtaining such waivers is underscored by the small number of class waivers that the SBA provides for IT equipment. For example, under NAICS 334111, there are only three class waivers for IT-related products. This indicates the absence of a sufficient number of small business manufacturers to fulfill the Government's IT requirements. See [www.sba.gov/sites/default/files/NMR%20CLASS%20WAIVER%20LIST-AS%20OF%2012-31-2013-VERSION%2010.pdf](http://www.sba.gov/sites/default/files/NMR%20CLASS%20WAIVER%20LIST-AS%20OF%2012-31-2013-VERSION%2010.pdf).

15 U.S.C. §632(a)(6).<sup>18</sup>

As noted above, none of the SBA's data properly reflects the current federal marketplace, and in particular the business of the ITVAR.<sup>19</sup> On the contrary, it appears quite clear that the SBA does not have and did not use applicable, complete, relevant or current market data regarding the impact of removing the Note 18 employee size standard from NAICS Code 541519. More pointedly, with such an obvious flaw in the data, the SBA's passage of the Proposed Rule violated the congressional dictates of Section 1661 and would, therefore, under any objective standard, be considered arbitrary, capricious and an abuse of the SBA's discretion with respect to its rulemaking authority. Again, by contrast, our data shows that at least 43 percent of ITVARs currently qualified under Note 18 who have received recent awards under First Source II, NetCents-2, SEWP V and/or CIO-CS contracts **will lose** their small business size status if the Proposed Rule is adopted.

### CONCLUSION

The SBA's proposed change to NAICS 541519 will have a severe negative impact on the small companies that depend upon those contracts. The substantial adverse impact of SBA's proposed change may force many small ITVARs to lay off employees or shut down their businesses entirely. In forcing these small ITVARs out of the market, competitive bids to the Government will be reduced.

The Proposed Rule will also have a particularly significant impact on those small businesses owned by disabled American veterans, women and those HUBZone-certified companies who have located their businesses in economically distressed areas around the country. By affecting thousands of employees working for the small ITVAR community, the Proposed Rule will have a detrimental effect on the local economies in which these businesses are located. This significant negative impact on small businesses and their employees is not justified by the rationale set forth in the Proposed Rule, which it is not supported by objective data, and contradicts SBA's own conclusions on the same issue without adequate explanation for the significant departure from prior policy.

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<sup>18</sup> We believe (and agree with Rep. Graves in his November 10 letter) that the SBA has violated other standards under Section 1661 not only with regard to NAICS 541519, Note 18 but also with regard to other revised size standards as set forth in the Proposed Rule, to include violation of the common size standard requirements under 15 U.S.C. §632(a)(7), as well as the SBA's improper limitation of size standards addressed in the Proposed Rule in violation of 15 U.S.C. §632(a)(8). Graves letter at pp. 9-11.

<sup>19</sup> The Proposed Rule stated that "SBA welcomes comments on its methodology for incorporating the Federal contracting factor in its size standard analysis and suggestions for alternative methods and other relevant information on small business experience in the Federal contract market that SBA should consider." Proposed Rule at 53653. During our March 24 meeting, SBA officials stated that they were considering our alternative data as provided in **Attachment A** and invited us to provide additional data for the SBA to consider.

Equally significant is that the Proposed Rule will force the small ITVAR that survives this change to compete with large ITVARs having significantly higher annual receipts, substantially more employees and significantly higher levels of resources, which is directly contrary to the SBA's mission to assist small companies in competing with large companies on an even basis. Eliminating the 150 employee-based standard will cause companies to be either very small or very large. This is what the SBA is here to prevent – not facilitate - by eliminating the path to success for many small ITVARs.

For these reasons, I believe that the SBA should withdraw the Proposed Rule and consult further with the procuring agencies and affected small ITVARs, as well as this Subcommittee. In addition, Congress should adopt the Act to allow small businesses, including small ITVARs, the ability to administratively challenge these proposed changes to the NAICS to fully and fairly protect their interests.

Again, thank you for the opportunity to testify at this hearing. I will be pleased to answer any questions you or any member of the Subcommittee may have.



**STATEMENT OF STEVE CHARLES**

**CO-FOUNDER, IMMIXGROUP, INC.**

**“SIZING UP SMALL BUSINESS: SBA'S FAILURE TO IMPLEMENT  
CONGRESSIONAL DIRECTION”**

**BEFORE THE**

**COMMITTEE ON SMALL BUSINESS**

**SUBCOMMITTEE ON CONTRACTING AND WORKFORCE**

**UNITED STATES HOUSE OF REPRESENTATIVES**

**JUNE 4, 2015**

**INTRODUCTION**

Chairman Hanna, Ranking Member Takai, and Members of the Subcommittee, thank you for the opportunity to testify on issues related to small business contracting and size standards. My name is Steve Charles and I am the co-founder of immixGroup, where for two decades I have worked to help technology manufacturers succeed in the government marketplace, in concert with their small business partners. I have also long provided training and thought leadership on these issues, including co-authoring *The Inside Guide to the Federal IT Market*, a comprehensive resource for technology companies interested in doing business with the government.

immixGroup is a small business success story. Since our founding in 1997, immixGroup has grown into a recognized leader in the public sector IT marketplace, representing more than 250 leading technology manufacturers and working with more than 600 value-added resellers, solution providers, service providers, and other public sector channel partners to bring the latest software and hardware solutions to the federal government.

We are a top ten IT 70 GSA Schedule contractor with sales in Fiscal Year 2014 of over \$420 million. We consistently have received awards and recognition for accomplishments in the technology industry, including, most recently, being named a BGov200 Top Federal Industry Leader and a Washington Post "Top Place to Work." On March 31, 2015, immixGroup was acquired by Arrow Electronics Inc., a Fortune 200 company and is a wholly owned subsidiary of Arrow Enterprise Computing Solutions, Inc. Moving forward, immixGroup looks forward to continuing its involvement in small business (and related) procurement issues on behalf of our small channel partners to help ensure clarity and consistency in existing regulations.

As a company heavily invested and experienced in the government acquisition process and the supply of technology products, immixGroup has a track record of success as an IT reseller. We have long been thought leaders on small business and contracting issues and work collaboratively with Congress and federal agencies, including the U.S. Small Business Administration (SBA). We truly appreciate the opportunity to share our thoughts with the Subcommittee this morning.

**IMPORTANCE OF SIZE STANDARDS**

It is critically important for the federal government to have small business size standards that accurately represent industry sectors for several reasons: (1) size standards determine business' eligibility to compete for contracts set-aside for small businesses; (2) size standards set eligibility for government programs reserved for small business concerns; and (3) size standards must be accurate to ensure government small business goaling targets are accurately tracked and reported. Thus, modifications to SBA size standards can have significant implications for SBA programs, federal procurement, agency rulemaking, any federal programs that deal with small businesses, and, of course, contractors.

The SBA uses the North American Industry Classification System (NAICS) as a basis for its size standards, which apply to all Federal government programs, including procurement. As the standard for all government acquisition, NAICS codes must be accurate and keep pace with industry norms to ensure the government is, indeed, working with a small business. NAICS codes are also critically important for the accurate tracking and reporting of federal spending because they are also used to identify the goods or services the government is purchasing. Incorrectly classifying an acquisition through the use of a wrong NAICS code can skew important data that inform policy decisions.

For this reason, immixGroup supports efforts to ensure that the SBA's review of size standards and NAICS code updates are done in a statutorily correct, transparent, and thorough manner. This is why a mechanism to formally challenge a size standard through the SBA Office of Hearings and Appeals—such as proposed in *Stronger Voice for Small Business Act of 2015* (H.R. 1429), introduced by Representative Mike Bost (R-IL) and cosponsored by our Congressman Representative Gerry Connolly (D-VA), is an important step moving forward. immixGroup also appreciates Chairman Steve Chabot's Small Contractors Improve Competition Act of 2015 (H.R. 1481), which would ensure that persons may file with the Office of Hearings and Appeals (OHA) petitions or reconsiderations of a size standard revised, modified, or established by the SBA Administrator.

**THE NEED FOR DATA IN SIZE STANDARD EVALUATIONS**

A key concern of immixGroup is the need for improved data as part of the size standard review process. By way of example, we need look no further than the SBA's recent proposed rule, "Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade (RIN 3245-AG51)." This proposal, in addition to updating industry size standards, would eliminate the Information Technology Value Added Reseller 150-employee size standard exception and Footnote 18 (collectively referred to hereafter as the "IT VAR exception") from SBA's table of size standards under NAICS 541519. As discussed in immixGroup's comments to the proposed rule, available [here](#),<sup>1</sup> we strongly support the SBA's end objective of striking the Footnote 18. We appreciate that this Committee has expressed strong reservations with the SBA's process in developing the proposed rule. Our hope is that, for reasons discussed below, issues related to Footnote 18 can be resolved in a way that promotes certainty and clarity within the procurement system.

By way of background, NAICS 541519 is a "services" code titled "Other Computer Related Services" falling under the "Professional, Scientific and Technical Services" section of the SBA Table of Size Standards. The IT VAR exception requires a contract to be comprised of at least 15 percent and not more than 50 percent of value added services (VAS). By extension, the contract must then consist of at least 50 percent and not more than 85 percent products. Thus, by definition, services under the IT VAR exception can never comprise the majority of a procurement. In other words, under 541519 Footnote 18, supplies must comprise the majority value while being reported as services in the government's procurement data system.

In the SBA's proposal, the Agency notes that that "the lack of data on characteristics of firms involved in IT VAR activities to evaluate the current 150-employee size standard also justifies SBA's proposal to eliminate the IT VAR sub-industry category." Indeed, immixGroup is not aware of any research that has been conducted to date on these issues. However, based on our experience, we firmly believe that if a non-partisan, independent review were conducted on

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<sup>1</sup> <http://www.regulations.gov/contentStreamer?documentId=SBA-2013-0010-0211&attachmentNumber=1&disposition=attachment&contentType=pdf>

recent solicitations using the IT VAR exception—with a focus at the delivery order level on the total value (amount) of products, labor hours, and fixed utilization —this research would clearly show how agencies' use of the exception has been confusing and misguided, and that it has in turn inhibited the ability of otherwise qualified small contractors to compete for federal IT products.

We believe that a thorough review of orders under the IT VAR exception as part of the proposed rulemaking would—in addition to being appropriate due diligence and providing added certainty—underscore the need to reform the IT VAR exception in the manner proposed recently by SBA.

## **BROADER SIZE STANDARD AND PROCUREMENT ISSUES**

### *Reforming the IT VAR Exception*

The IT VAR exception is a narrowly tailored footnote under a single IT services NAICS code, which applies only to small businesses that resell IT products. To our knowledge, it is the only footnote that creates a dual nature NAICS code and is, therefore, an anomaly.

Use of the IT VAR exception in small business set-asides has restricted competition and small business participation by allowing agencies to arbitrarily exclude qualified small businesses with more than 150 employees, when use of an available, applicable (and more appropriate) manufacturing NAICS code would not. Use of the more appropriate manufacturing (*i.e.* supply) based NAICS code, increases the small business size standard from 150 to 500 employees. For example, in an acquisition for laptop computers, a contracting officer should use a manufacturing NAICS code and size standard, such as NAICS 334111 (Electronic Computer Manufacturing). This NAICS code has [a] 1,000-employee size standard, to which the non-manufacturer (*i.e.*, reseller) size standard of 500 employees would apply by rule<sup>2</sup>. Use of NAICS 541519 Footnote 18 in this case: 1) excludes from competition a large segment of prospective small business contractors, which would be otherwise eligible and just as well equipped to deliver on these

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<sup>2</sup> See, FAR 52.212-1(a)

contracts; and 2) violates a contracting officers obligation to designate a NAICS code that best describes the nature of the acquisition and the items being bought (*e.g.*, products v. services).<sup>3</sup>

Further, when competition is restricted, the government often ends up paying higher prices. In short, the practical effect of 541519 Footnote 18 contravenes SBA's fundamental policy of increasing small business participation and the government's essential goal of increasing competition. On the other hand, eliminating the IT VAR exception will increase small business participation by opening up government acquisitions to otherwise capable and qualified small businesses.

Additionally, by using NAICS Code 541519, Footnote 18, agencies avoid critical small business protections, including the "non-manufacturer rule" (NMR) and "performance of work requirements," which are intended to ensure that small business is the ultimate beneficiary of set-aside contracts, but which do not apply either by law or operation to acquisitions using a services code.

Further, restricting acquisitions for IT products to small businesses under the IT VAR exception eliminates the country of origin requirements of both the Trade Agreements Act (TAA) and Buy American Act (BAA) thereby granting China and other non-designated counties an avenue to supply products directly to the U.S. Government.

FAR Subpart 25.4 (Trade Agreements) is expressly exempted from acquisitions set aside for small business<sup>4</sup> and commercial item IT is specifically exempted from the BAA.<sup>5</sup> As the NMR does not apply to contracts assigned a services NAICS code the domestic preference protection in that regulation (*i.e.* the requirement to furnish the end item of a United States small business) is likewise eliminated.

By eliminating the IT VAR exception, SBA would resolve the "inconsistencies, confusion, and misuse" created by Footnote 18. First, it has become common for procuring agencies to use the

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<sup>3</sup> 13 C.F.R. § 402(b)

<sup>4</sup> FAR 25.401(a)(1)

<sup>5</sup> FAR 25.103(e)

IT VAR exception under NAICS 541519 to designate multi-agency contracts (MACs) and government-wide acquisition contracts (GWACs) to buy COTS IT “products” (e.g., hardware and software). In many cases, these delivery order contracts consist of less than the 15 percent value added services as required and thus, the solicitation should have been classified under the appropriate manufacturing (i.e., supply) NAICS code. By using the IT VAR exception to classify these acquisitions federal agencies often confuse the principle purpose of the items being acquired (as required by SBA regulations) with the source of those items.

The IT VAR exception also breeds confusion and ambiguity because, by definition, an acquisition under it can never consist of a majority of services and often consists overwhelmingly of supplies. Yet, through use of the IT VAR exception, agencies classify procurements for supplies as services (task order) contracts. This contradicts the requirement in 13 C.F.R. § 121.402(b) that requires a contracting officer to select a NAICS Code that best describes the “principal purpose” of the acquisition. Further, when procurements are misclassified, it becomes very difficult to produce meaningful data, accurately track government spending, and formulate policy. An acquisition of IT products will look like one for IT services.

For these reasons, immixGroup was pleased that SBA identified the problems associated with the IT VAR exception and proposed to address and resolve these problems. We hope that the agency will finalize workable policy in an appropriately timely manner to ensure fairness, transparency, and accurate data reporting in the small business contracting space. We urge SBA and other agencies to continue to thoughtfully evaluate rules and regulations governing IT resellers.

Some opponents of the Footnote 18 elimination seem to completely misunderstand the IT VAR exception’s limited applicability and impact, erroneously arguing that this change will somehow shut out every “mom and pop” business in every industry. In reality, however, this is a narrowly tailored footnote under a single IT services NAICS code, which applies only to small businesses that resell IT products. Again, it is an anomaly in the size standard framework. The proposed change does not impact all industries or businesses and hardly sounds the death knell for SBA or U.S. small business.

We do, however, understand some of the opposition's concerns. The elimination of the IT VAR exception and corresponding 150 employee size standard may instantly make some of these small business resellers large for acquisitions of IT services under NAICS code 541519's current revenue based small business size standard of \$27.5 million. However, for acquisitions where the majority of the dollar value is spent on products, these resellers would remain small under the 500 employee size standard for non-manufacturer resellers under an applicable manufacturing NAICS code.

We take no position on what the appropriate small business size standard should be under NAICS 541519 – Other Computer Related Services.

Rather, our message is that SBA's proposed elimination of the only dual nature and arbitrary NAICS code will lead to clarity for industry, force agency compliance with current SBA regulations, eliminate serious loopholes that work to the detriment of small business and allow government to accurately track spending both in terms of small business goaling and what is actually being purchased within the framework of the NAICS.

*Non-Manufacturer Rule and the Failure of Government Set Asides*

Related to SBA's IT VAR exception proposal, on December 29, 2014, SBA released another proposed rule to implement proposed clarifications to the NMR and clarifications regarding the nature of COTS software (Small Business Government Contracting and National Defense Authorization Act of 2013 Amendments (RIN 3245-AG58)). immixGroup supports addressing the problems associated with the real-world operation of the NMR and SBA's proposed clarification that COTS software is and should be treated as an item of supply; however, we recommended to SBA in our comments that it go further to clarify that acquisitions using NAICS 511210 for COTS software are then subject to the 500 employee (non-manufacturer) small business size standard under FAR 52.212-1(a) and FAR 19.102(f).

In designating a NAICS code, the procuring agency is required to select “the NAICS code which best describes the principal purpose of the product or service being acquired.”<sup>6</sup> Where both products and services are being acquired, acquisitions must be classified according to the component which accounts for the greatest percentage of contract value.” Once properly assigned, the NAICS code has a corresponding size standard, which is represented by either a dollar figure (*i.e.*, annual receipts) or number of employees (*i.e.*, headcount).

When a procurement is restricted for small business, accurately representing size status against the standard applicable to the NAICS code identified in the solicitation, however, is only the first (and perhaps the easiest) step for a non-manufacturer reseller. Once the contractor’s size status is appropriately determined and certified as small, the contractor still must comply with other SBA regulations, such as the NMR.

The NMR sets out the requirements for resellers to provide supplies under a small business set-aside. The NMR applies only when: 1) the procurement is set aside for small business; and 2) the procurement has been assigned a manufacturing or supply NAICS code. In such cases, the reseller must, among other things, have fewer than 500 employees and, in the absence of a waiver under 13 CFR 121.406(b)(5), furnish the end item of a U.S. small business.

While the rationale behind the NMR is to prevent large business from using small business as a front that simply passes through the majority of the government’s small business contracting dollars to a large original equipment manufacturer (OEM), frequently—and especially in the IT market—the items desired by the government are manufactured only by large business.

Thus, while government agencies want to buy from small business, the IT products government agencies desire are not made by small businesses but, rather, are only sold by small businesses. Typically, large OEMs (*e.g.*, IBM, Oracle, and McAfee) sell commercially (and to the public sector) through a network of resellers and distributors known as channels of distribution (*i.e.* the “channel”). Some OEMs employ wholesale distributors, who sell to resellers, who then sell to

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<sup>6</sup> 13 C.F.R. § 402(b)

the end user government customer. This is commonly referred to as a “two-tier” channel model. Other OEMs simply sell to resellers, who then sell to the end user government customer.

Given the structure of the IT supply chain, the practical application of the NMR, which requires resellers to provide the end item of a U.S. small business, makes almost any set-aside for IT products defective in the absence of an applicable (and rarely obtained) waiver. Where a procurement for IT products is reserved for small business, it is virtually impossible for any small business prime to perform the requirements of the contract without violating the NMR.

immixGroup sees dozens of delivery orders each week restricted for small business, yet at the same time specifying a name brand product manufactured only by a large OEM. In the absence of an applicable waiver, we believe such procurements are defective because no non-manufacturer reseller could provide the end items of a U.S. small business.

This puts small business government contractors in an untenable position. First, the awardee (or offeror) can approach the Contracting Officer and explain the existence and application of the NMR. Some Contracting Officers are receptive to that explanation and will restructure the acquisition, usually reclassifying it as full and open. Other Contracting Officers refuse to discuss the issue or modify the solicitation.

Second, if the award remains set-aside, the contractor could protest the award – something unheard of, since winning bidders typically do not protest. In any case, this is not a viable option when considering business realities and valued relationships with OEM suppliers, whose products were listed in the delivery order or on the solicitation.

Third, the contractor could comply with the NMR and not bid on the opportunity or accept the award. This is also an unrealistic position as, once again, ongoing business realities and relationships with OEM suppliers come into play.

This leaves the fourth and final option – the contractor could accept the order and knowingly breach the NMR. While it is unclear whether a violation of the NMR by a contractor is the same

as a misrepresentation of size status subject to the strict liability and presumption of loss penalties of the *Small Business Jobs Act of 2010* (we think it is not), we do certainly see any violation of SBA regulations as serious and subject to substantial penalty.

The issue of the NMR reflects an ongoing misunderstanding of the structure of the government's IT supply chain. Specifically, set-asides for IT product solicitations lead only to confusion, uncertainty and potential liability – and not to increased small business participation or protection.

*Modernizing Size Standard Classifications for IT Products*

SBA's December 2014 proposed rule also seeks to clarify the nature of COTS software. immixGroup strongly supports SBA's direction in this regard and believes there has long been confusion and uncertainty about how to properly classify COTS software and, consequently, how to apply the NMR in set-aside acquisitions for such items. We view this as extremely significant given that in FY 2014 on the GSA IT 70 MAS contract alone, the Government purchased over \$14.15 billion worth of software and related maintenance and support.

The SBA's current Table of Size Standards contains only one NAICS Code that describes the processes of programming, developing, selling and supporting software – 511210 (“Software Publishers”), which is currently characterized as a “service” indicated by its revenue based small business size standard.<sup>7</sup> This NAICS code falls under “Sector 51 – Information” and not under a manufacturing or a services NAICS code. However, the true nature of COTS software is much closer to that of a commodity (*i.e.*, a “supply” or “product”) than a service. For instance, Microsoft Word is a productivity tool, not a service. It requires no people or labor hours to deliver to a customer. It is analogous to book publishing, which is accurately classified as a product. Software development, on the contrary, does require professional services (labor hours) and should be classified as such under Sector 54—Professional, Scientific and Technical Services.

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<sup>7</sup> Items of supply (*i.e.*, products) are designated in SBA's Table of Size Standards by employee based size standards whereas services are designated by revenue based size standards.

In our comments to the SBA, which are available [here](#),<sup>8</sup> immixGroup hopes SBA will go a step further to specifically explain that because COTS software is to be treated as a supply, the 500 employee small business size standard for non-manufacturers under 52.212-1(a) and FAR 19.102(f) would apply to acquisitions for COTS software utilizing 511210 and not the \$38.5 million revenue-based standard.

Further, having only one software-based NAICS Code is insufficient to accurately categorize and describe the three different software industries that exist in the commercial market today. COTS, Cloud, and Developmental items should not be lumped into one “catch-all” category as they each are of a different nature and thus require unique NAICS Codes. immixGroup urges the Administration and Congress to take appropriate actions to address this issue and we stand ready to be a resource.

#### **THE GSA’S TRANSACTIONAL DATA REPORTING PROPOSAL AND THE BURDEN POSED TO SMALL CONTRACTORS**

Finally, we would like to take this opportunity to share with the Subcommittee our perspective on the General Services Administration’s (GSA) March 4, 2015 proposed rule, *General Services Administration Acquisition Regulations: Transactional Data Reporting* (GSAR Case 2013-G504), which would establish a new transactional data reporting clause. This clause would require GSA Schedule contractors to report monthly on prices paid by ordering activities for products and services through what GSA describes as a “user-friendly, online reporting system.”

The proposal would also remove the Basis of Award monitoring requirement of the existing Price Reductions Clause (“PRC”), which requires contractors to track its commercial sales to a defined customer (or category of customers) agreed upon at the time of contract award to ensure the government’s pricing remains less than or equal to the prices charged those commercial customers. The proposed rule would not do away with Commercial Sales Practices (“CSP”)

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<sup>8</sup> <http://www.regulations.gov/contentStreamer?documentId=SBA-2014-0006-0119&attachmentNumber=1&disposition=attachment&contentType=pdf>

disclosures, which document the pricing, terms, and conditions a vendor offers to its commercial customers in order to determine a fair and reasonable price at the GSA contract (catalog) level.

immixGroup applauds GSA's recognitions that: (1) the market and competition drive pricing; and (2) the PRC is confusing, burdensome, and ineffective. However, immixGroup believes that GSA's proposed rule replaces an existing burdensome data collection process with a new, more onerous process and misses an opportunity to address broader systemic problems. As noted by the Coalition for Government Procurement (CGP), the GSA proposal as currently written would impose on industry significant time, price monitoring, tracking and reporting burdens on a monthly basis—well beyond GSA's estimates. According to the CGP, the cumulative cost of the reporting burden imposed by this rule would be 30 times that of GSA's estimate in year one of the proposal.

*SBA Office of Advocacy Cautions GSA on Proposed Rule*

The SBA Office of Advocacy, the “Regulatory Watchdog” for small business, submitted comments to GSA on the proposed transactional data rule.<sup>9</sup> The Office of Advocacy recommended postponing the rulemaking to conduct a formal stakeholder outreach process throughout the country. During this delay, the Office of Advocacy also urged GSA to conduct a more detailed impact assessment of this proposed rule on small businesses and take into consideration the rate of small business participation in the acquisition process and not just focus on the percentage of dollars being awarded to small businesses. This assessment should also include an examination of the potential unintended consequences of this rule on small business resellers because the lack of data in the Initial Regulatory Flexibility Analysis (IRFA) makes it unclear how GSA will balance the potential conflict between small businesses that are on a GSA schedule who are also value added resellers to the same original equipment makers who are also on GSA schedules. The Office of Advocacy's comments reflect concerns expressed by small businesses that the IRFA for this transactional data collection and reporting rule does not provide them with a clear understanding of GSA's legal framework moving forward and concerns over

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<sup>9</sup> See Advocacy's complete comments at <https://www.sba.gov/category/advocacy-navigation-structure/legislative-actions/regulatory-comment-letters>.

how transactional data will be collected as well as concerns about unintended consequences and burdens posed by the rule.

*GSA's Proposed Rule Does Not Address the Conundrum of Its Statutory Authority*

In addition to concerns about regulatory burdens shared by the Office of Advocacy, immixGroup believes that GSA's statutory authority must be modified to allow achievement of the "lowest overall cost alternative" either at contract level or order level, but not require both. (See 41 U.S.C. §152). In truth, order level, competitive pricing, not catalog pricing, is where ordering activities realize the lowest overall cost. immixGroup encourages GSA to consider building on its efforts to maximize competition rather than adding burdensome tracking and reporting obligations. GSA needs to recognize that order level competition, orchestrated by actual buyers with funded requirements, ensures the government receives the "lowest overall cost alternative" (just like the commercial world).

It is illogical for contract catalog pricing on multiple award, non-mandatory contracts with ordering procedures that require competition at the order level to be the lowest available cost alternative.

The obligation to provide CSP disclosures goes toward justifying and negotiating fair and reasonable pricing at the catalog level. This is the fundamental problem and current bottleneck of the GSA Schedules program. Vendors cannot and will not provide anyone (the U.S. Government included) their best pricing for a quantity of one with no purchase commitment that is then also visible to the entire world via the Internet.

CSPs do not serve either government or industry well in establishing catalog pricing and are not necessary for GSA to deliver the "lowest overall cost alternative," because the real savings, indeed the lowest overall cost alternative (as GSA acknowledges), comes from order level

competition. The obligation to disclose CSPs results in undue confusion and burden for both parties and delay in making available the cutting edge technology ordering activities desire.<sup>10</sup>

Artificial mechanisms like CSPs and the PRC have not, and will not, result in end customers receiving the lowest overall cost alternative.

GSA must evolve its thinking and processes from an antiquated notion of the importance of contract level pricing to a modern framework of ensuring transparent order level competition among carefully vetted suppliers under pre-negotiated terms and based on catalogs that are current to the day. It should also involve the Office of Inspector General and the relevant Congressional oversight committees in this conversation as this approach represents a real departure from the status quo.

We suggest Congress work to amend the relevant statutory language to allow for the lowest cost alternative either at the contract level or ordering level. This would provide GSA the authority to rely exclusively on order level competition to ensure fair and reasonable pricing and the ability to discard the inefficient and burdensome CSP disclosure requirement in favor of a more nimble method of adding and updating products and pricing to its catalogs.

## **CONCLUSION**

In conclusion, immixGroup thanks the Subcommittee for considering common sense measures to ensure that SBA conducts size standard evaluations in a transparent, data-driven manner that fully complies with the letter of the law and which results in the size standards that best represent the nature of the industry in question. By giving a small businesses the opportunity to challenge an inappropriate SBA size standard through the SBA Office of Hearings and Appeals, H.R. 1429 would certainly further this goal.

Above and beyond statutory and procedural issues surrounding size standards, immixGroup believes that additional items of concern—such as the elimination of the IT VAR exception,

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<sup>10</sup> In our experience it could take six (6) months or more to get items on our GSA Schedule compared to two days on other GWACs, which are not hindered by the same statutory mandate to negotiate pricing at the catalog level.

clarification of the NMR (and nature of COTS software), and the need for additional NAICS codes to accurately describe the different kinds of commercial software outlined above—also reflect the need to craft size standards in a way which complies with applicable statutes and promotes clarity.

Again, thank you Chairman Hanna and Ranking Member Takai for the opportunity to testify. I would be pleased to answer any questions you or members of the Subcommittee may have.



## THE AMERICAN INSTITUTE OF ARCHITECTS

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### **“Sizing Up Small Business: SBA’s Failure to Implement Congressional Direction”**

#### **Statement of Ronald M. Reim, AIA**

On Behalf of the American Institute of Architects

United States House of Representatives  
Committee on Small Business  
Subcommittee on Contracting and Workforce  
June 4, 2015

#### **Introduction**

Chairman Hanna, Ranking Member Takei, and members of the Subcommittee, thank you for the opportunity to testify today on behalf of my firm and the American Institute of Architects (AIA) on the critical issue of the Small Business Administration’s (SBA) size standards.

My name is Ronald M. Reim, AIA. I am the Executive Vice President and a founding principal of Oculus Inc., a full service architectural, strategic facility planning, interior design, and move management firm with offices in St. Louis, Missouri, and Dallas, Texas. In addition to serving these communities, we work with a number of federal agencies on a wide array of projects. Our firm did our first federal design work as a team member on a design-build project for the Internal Revenue Service (IRS) in 1995.

Since the height of the economic crisis in 2008, our nation has made tremendous strides towards full recovery, a testament to the resilience of the American economy and its workforce. But, as members of this Committee have seen firsthand, small businesses like mine were particularly devastated by the downturn and are still feeling those effects today. As such, we are grateful for the assistance and resources provided by the SBA.

Our designation as a small architectural practice has helped our company bridge into more complex, interesting, and meaningful projects. We have leveraged our federal experience back to our private sector work. Our government IDIQ contracts have provided exposure in a leadership/management role on more complex projects, different project types, and in different roles. We have excelled at this, built expertise, and worked diligently to expand our capabilities.

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However, we remain deeply concerned about the harsh consequences that changes to size standards would yield for Oculus and the majority of AIA members and their businesses.

### **The Architectural Profession and the Recession**

Architects, overwhelmingly, are small businesspeople. With more than 95 percent of architecture firms in the United States employing 50 or fewer people<sup>1</sup> – and many architects working in one- or two-person firms – the profession is a true embodiment of the spirit of small business entrepreneurship.

Hiring an architect leads to employment in other construction-related fields, from engineers and manufacturers, to steel and electrical contractors. Architects are job catalysts, serving as the engine that drives the design and construction industry. We are the concept creators that allow clients to envision what their future project might be like. Often this creative work is the initial starting point for not only construction but activity in many other sectors, including development, real estate, legal, and banking. A study by the George Mason University Center for Regional Analysis found that every \$1 million invested in design and construction supports 22 new full-time jobs.<sup>2</sup>

Activity within the design industry is closely correlated with future construction work; that is, when architects are busy, a similar uptick in the construction industry is likely to follow. The AIA Architecture Billings Index (ABI), a diffusion index derived from monthly surveys of AIA member firms, consistently serves as a leading economic indicator of nonresidential construction trends a full year in advance, and demonstrates the integral role that design firms play in the construction industry.

The ABI, unfortunately, also shows that this critical sector of our nation's economy is still very much in the recovery phase. The index tracks moving averages of the work being done at architecture firms across the country, and each month assigns a score that is a comparison to the previous month's figures. A score of 50 indicates no change in billings from the previous month, while numbers above or below that represent a growth or decline in billings. Since its peak decline in late 2008, the ABI has trended upwards, but for the past several years has continued to hover just above or below this "zero growth" baseline.<sup>3</sup>

The data reflects a sentiment shared by me and many of my colleagues in the architectural profession: although we have come a long way since the depths of the financial crisis, we are not out of the woods yet. With small businesses still feeling the ripple effects of the downturn, there is much work that remains to bring the economy back to full strength. Architects are busiest during periods of real growth when there is new development work taking place. Consequently, many saw their workload evaporate during the recession, and are only now just beginning to see it return.

<sup>1</sup> *The Business of Architecture: 2012 AIA Firm Survey Report*

<sup>2</sup> *Economic Impacts of Commercial Real Estate* (2014 Edition). Stephen Fuller, PhD, Director, Center for Regional Analysis, George Mason University, from: <http://www.naiop.org/-/media/Research/Research/Research%20Reports/Economic%20Contributions%20of%20Commercial%20Real%20EstateMedia%20Folder/Full%20Report.ashx?la=en>

<sup>3</sup> *Designing the Construction Future: Reviewing the Performance and Extending the Applications of the AIA's Architecture Billings Index*. Kermit Baker, Ph.D., Hon. AIA; James Chu; and Jennifer Riskus. The American Institute of Architects, (pp. 13) from: <http://www.aia.org/aiaucmp/groups/aia/documents/pdf/aia102055.pdf>

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During the recession our firm was forced to cut staff sharply and reduce compensation across the board to survive. For the most critical six month period, senior staff had their pay reduced by 20 percent, intermediate staff by 10 percent, and junior and support staff by five percent. As soon as we were able, we began working to restore pay. Our employment numbers dropped from a total of 42 to our lowest point of 15. It was nearly two years before we added our first new employee. We have since slowly grown back to our current size of 26 employees.

In fact, early in the recession, our firm was excluded for a year from the small business designation under the previous architectural firm size limits (\$4.5 million in annual gross receipts). A significant amount of what pushed us over the limit was pass-through revenue on both our private/commercial projects as well as our federal work.

A number of external factors have already driven up the costs of doing business for the architectural profession as a whole; modifications to the SBA size standards would greatly exacerbate these problems and elevate the challenges we face to an untenable level.

#### **The Effect of SBA Size Standards on Architects**

My firm is grateful for the assistance that the SBA has provided, as are firms at which thousands of AIA members get up and go to work each day. Given the vast number of small businesses that are impacted by the SBA's rulemaking changes, significant attention and scrutiny should be paid to any proposed modifications.

Dramatically increasing these standards, an issue that emerged in 2011 when the SBA proposed a radical transformation of the small business definitions, would create ripple effects much like some of those felt in the aftermath of the economic crisis. That year, the SBA released its proposal to lump together architecture and engineering firms and impose a single, massive size standard that would include all but a small percentage of architecture firms in its classification of "small business." The rule would have dramatically increased competition among firms for an ever shrinking pool of available work, and essentially double down on one of the most pernicious aspects of the financial downturn.

Architecture and engineering firms have very different characteristics. While Oculus Inc. does offer different services under the architectural umbrella (architecture, interiors, move management and planning), we are different in many ways from engineering companies, which have much broader swaths of specific expertise and revenue generating ability. In addition, a significantly smaller percentage of revenue flows through engineering practices to outsiders. Consequently, revenue is a much better indicator as to an engineering firm's size than it is to an architectural firm.

Lumping us together with engineers and raising the definition of a small architectural firm would be crippling to our firm, as well as to a multitude of talented emerging practices, essentially forcing them to compete with firms five or even 10 times their size. It would very likely result in the consolidation of architecture practices and a loss of jobs.

In 2011, the AIA testified before the full Committee in opposition of this very change, and hundreds of AIA members expressed similar sentiments to the SBA. Thankfully, the SBA heard those voices and issued a revised size standard for architectural firms that was more in line with reality. The AIA also was pleased to work with the Committee in 2012 to advance legisla-

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tion, the Small Business Protection Act, to ensure that the SBA would not make the same mistake by limiting its ability to lump together disparate industries into a single size standards.

Because the size standard for architectural firms may be revisited in the near future, I am concerned that the lessons of the past might not be heeded. More than nine of every ten architecture firms, Oculus included, are already classified as small businesses. The challenges described here are ones we face on a daily basis, and even moderate changes to SBA definitions could have dire consequences for thousands of firms if an influx of disproportionately larger businesses were suddenly introduced into the marketplace. In other words, changes in the SBA's size standards could significantly worsen an already challenging environment for small businesses in the architectural field.

Substantially raising the size allowance would, for all intents and purposes, eliminate Oculus' ability to compete for federal government work. It would essentially reclassify mid- to large-sized firms as small firms, David would now be classified the same as Goliath, yet competitively they would be very different, resulting in significantly imbalanced competition.

The current size limitation for small firms provides opportunities for truly small businesses to have a legitimate shot at performing federal work and gaining access to restricted set-aside contracts. This allows an emerging firm to gain project experience, grow, and hopefully someday become a truly large company. Mid-to-large firms, who now add small firms to their teams for selective aspects of projects, would no longer have a reason for doing so, as they themselves would fill the role of the "small firm." This would shut the door to even sub-consulting opportunities. In doing so the SBA would all but eliminate the chance of a truly small firm ever gaining the requisite experience and qualifications necessary to compete for and win a federal project.

Had the proposed 2011 size standard been put into place, my firm, and many others, would still be operating today in a very unbalanced, inequitable environment, being forced to compete with much larger firms for small business set-asides. Most likely, we would make little attempt to grow and develop our expertise to even compete for these projects. Valuable experience, training, and developmental benefits would be lost, and the number of large firms performing the work would likely concentrate. The SBA is required to review and adjust size standards only once every five years. Five years of being shut out of the marketplace can be crippling to a small firm, where cash flow and access to finance are a daily struggle.

That is why it is essential that the SBA gets size standards right. It is also why I am pleased that members of this Committee, led by Reps. Mike Bost (R-IL) and Gerry Connolly (D-VA), have introduced H.R. 1429, the Stronger Voice for Small Business Act. This legislation, which has been endorsed by the AIA, would enable small firms to challenge size standards decisions in the SBA's Office of Hearings and Appeals, instead of being forced to go through a lengthy and expensive legal process. I am pleased that the House incorporated this bill into the National Defense Authorization Act, and I hope it can become law this year.

#### **Use of Receipts as a Metric**

Related to the issue of size standards is how subcontractor payments are calculated in the net revenue of an architectural firm. In the past, AIA members have stated that over 50 percent of their gross revenue can be attributed to payments that flow through to subcontractors. Those

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payments increase the firm's gross revenue number, but are not part of the firm's revenue; they are a misleading figure and often paint an inaccurate picture of a business' cash inflows.

In many instances, architecture firms merely serve as a "collection point" for revenues, and pass significant portions of that money onto subcontractors rather than actually seeing it go into the business. This can be particularly true when a firm holds an IDIQ contract with a federal agency, as the architecture firm often serves as the point of contact or the "prime" contractor for all other disciplines, even for work or projects that are primarily engineering. On those projects, a substantial percentage of the fees flow through the architecture firm with little to no direct employment, gain, or profit for the firm.

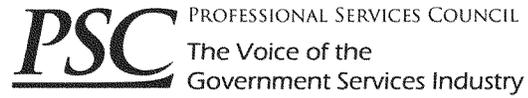
To suggest that a firm is not a small business merely because it "handles" that revenue, however briefly, before using it to pay other firms is unfair. The SBA could easily address this issue by counting only the revenue that accrues to the firm and not the revenue that is passed through to subcontractors, and we ask for the support of this Subcommittee in recommending the implementation of this change.

Another issue that impacts Oculus and thousands of firms is the SBA's use of receipts as a metric for small business designation. Typically, service industries have a net revenue standard, while a small percentage of manufacturing and sales industries have a standard set at number of employees. Although there is the potential to change the architecture standard from receipts to employees, the SBA is not contemplating this, and it would likely take a legislative effort. We would like your support on changing the architectural standard from receipts to employees, so that it will more accurately reflect the nature of the architecture business.

#### **Conclusion**

The SBA is an immensely valuable institution that has helped innumerable small businesses thrive, both within the architectural profession and throughout the American economy. The SBA's vast reach, however, means that even minor changes to its policies can have dramatic consequences, chief among them size standard definitions. Therefore, as the SBA conducts its five-year detailed review of these standards, we ask that the SBA follow the letter and intent of the 2012 law, and ensure that any adjustments made reflect current market conditions.

In conclusion, I would like to thank Chairman Hanna, Ranking Member Takei, and the distinguished members of this Subcommittee for giving me the opportunity to testify before you today. The problems we face as small businesspeople are serious, but so is our commitment to leading efforts to rebuild our country. Thank you for your leadership and continued efforts.



TESTIMONY OF  
ROGER JORDAN  
VICE PRESIDENT OF GOVERNMENT RELATIONS  
PROFESSIONAL SERVICES COUNCIL  
BEFORE THE  
SUBCOMMITTEE ON CONTRACTING AND THE WORKFORCE  
COMMITTEE ON SMALL BUSINESS  
U.S. HOUSE OF REPRESENTATIVES  
“SIZING UP SMALL BUSINESS: SBA’S FAILURE TO IMPLEMENT  
CONGRESSIONAL DIRECTION”  
JUNE 4, 2015

Chairman Hanna, Ranking Member Takai, and members of the Subcommittee, thank you for the invitation to testify and the opportunity to discuss small business size standards.

My name is Roger Jordan and I am the vice president of government relations at the Professional Services Council. PSC is the national trade association of the government professional services and technology industry. PSC's nearly 400 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, cybersecurity, facilities management, operations and maintenance, consulting, international development, scientific, social, environmental services, and more. Roughly 20 percent of our members are small businesses and another approximately 30 percent would be considered small mid-tier firms. Together, the association's members employ hundreds of thousands of Americans in all 50 states.

#### The Importance of Size Standards

Small business size standards and the associated North American Industry Classification Systems (NAICS) play an often overlooked, yet significant role in the federal contracting marketplace. Whether a specific industry's size standard is employee-based or revenue-based, the methodology used by the Small Business Administration and the resultant size standard impacts competitiveness throughout the marketplace, including contracts that are set aside for small business competition and prime contractors' subcontractor utilization plans and implementation. For companies throughout the supply chain, size status carries significant weight not only because of the benefits offered by small business size status but also because of the potential penalties associated with misrepresentation of size status. Hence, there is broad interest whenever the SBA undertakes a review of, or revision to, an industry size standard.

Such interest and impact is amplified by the binary nature of the size standards: companies are either small business or "other-than-small." This binary approach means that once a company exceeds its industry size standard, even if only by one dollar or one employee, they are left on their own to compete in the full and open marketplace. Some will succeed, others will not. In short, since SBA's decisions can have transformational impacts on individual companies, the importance of accuracy and consistency in conducting size standard reviews cannot be overstated.

At PSC, we believe the philosophy of the overall small business program should be to facilitate long-term growth of companies with entrepreneurial spirit through awards to and performance of federal government contracts. We believe this philosophy is shared by the current SBA leadership. However, it is not always evident in policy or practice.

The statutory definition of a small business is designed to include firms that are not dominant in their primary field. But achieving an appropriate balance that allows companies with revenues or employees at the lower end of the size standard to break

into the market while also protecting the ability of companies that are larger, but by no means “dominant” in their field, to compete for set-aside opportunities is not a simple endeavor. At the time SBA initiated its review of the size standards, PSC’s position was, and remains, in support of size standards that lean toward the higher range. SBA must seek to balance size standards so that all small businesses have legitimate opportunities to compete, yet higher revenue generating small firms are not shut out from competing for small business set-asides. PSC’s position has been and continues to be that federal government policies should foster robust competition for federal contracts whether set-aside for small businesses or not. As such, we have not endorsed legislative proposals to create new set-aside programs, particularly for emerging or very small businesses.

Prior to 2009, it had been nearly 30 years since a comprehensive revision to industry size standards was conducted, and PSC was calling upon SBA to undertake a thorough analysis of the size standards, particularly for the “54” or “Professional, Scientific, or Technical Services” sector in which many PSC member companies operate. Examples of industries that fall under sector “54” include legal services, tax preparation services, architectural and engineering services, many computer related and information technology services, and a number of consulting services, including management consulting, logistics consulting, scientific and technical consulting.

Hence, PSC was pleased that SBA began a comprehensive review of the size standards in 2009. SBA began its process of revising the size standards by developing a methodology based on five significant factors: average firm size; startup costs and entry barriers; industry competition; distribution of firms by size; and impact on federal contracting and SBA loan programs. SBA also considered other factors such as technological changes and industry growth changes. In addition, SBA established their discretion to use “common size standards” for industries that share similar characteristics. According to SBA, these common size standards reflect cases where many of the same businesses operate in multiple industries, and might also make size standards among related industries more consistent than establishing separate size standards for each of those industries.

#### PSC Concerns with the SBA Approach

In December 2009, PSC submitted comments to SBA on their proposed methodology. SBA finalized this methodology in 2010 but did not accept any of our recommendations.<sup>1</sup>

Subsequently, in March 2011, SBA issued a proposed rule to revise the size standards for 36 industries in the “54” category. In total, federal spending on contracts in this category represents over \$100 billion, or 20–25 percent, of the government’s annual spending on contracts.

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<sup>1</sup>PSC comments on the SBA Size Standard Methodology are available at [http://www.pscouncil.org/PolicyIssues/SmallBusiness/SizeStandardsSetAsides/Comments\\_on\\_Other\\_Se.aspx](http://www.pscouncil.org/PolicyIssues/SmallBusiness/SizeStandardsSetAsides/Comments_on_Other_Se.aspx).

While PSC recognized the difficulty SBA faced in collecting and digesting significant amounts of data about the commercial and federal marketplaces, we raised a number of concerns with the SBA proposed rule.<sup>2</sup>

On February 10, 2012 SBA published a final rule regarding the “54 category” that increased size standards for 34 specific industries. For most industries, the increases to the size standards were fairly substantial. For example, most size standards that had been established at \$7 million in annual gross receipts were increased to either \$10 million or \$14 million. That increase provided much-needed flexibility for small firms to mature while still having access to restricted competition. In our comments on this proposed rule, we raised concerns about proposals for computer-related services that we believed required greater scrutiny, and our views remains unchanged.

Our concern is that SBA is ignoring the fact that computer-related services has undergone, and continues to undergo, significant changes over the last 25 years. The federal government is purchasing more of these services than at any time in its history and companies across the industry are focusing on providing a comprehensive set of solutions and offerings to the federal government that include a combination of telecommunications, information technology and other solutions and services. Yet, in 2011, the SBA proposed raising size standards for those categories by only \$500,000, from \$25 million to \$25.5 million. The \$25.5 million size standard remained unchanged in SBA’s final rule.<sup>3</sup>

#### Common Size Standards

Additionally, SBA established a common size standard for the Computer Systems Design and Related Services industries (NAICS 541511, NAICS 541112, NAICS 541513, NAICS 541519 and NAICS 811212), even though the industry data supported a distinct size standard for each industry. The common size standard proposed by SBA for these categories was also \$25.5 million. However, SBA’s own analysis shows that for NAICS 541513—Computer Facilities Management Services—the calculated industry-specific size standard is \$35.5 million. Therefore, by establishing a common size standard that incorporates this NAICS category and other computer related categories at a common level of \$25.5 million, SBA has eliminated legitimate small businesses from being able to qualify. PSC’s comments to SBA focused heavily on this point. However, SBA declined to adopt our recommendations that “common size standards” be avoided and instead retained a size standard of \$25.5 million for all computer-related NAICS codes.

To this committee’s credit, you recognized that the reliance on “common” size standards could have a negative effect on small businesses, and in May 2011 the Subcommittee on Economic Growth, Access to Capital, and Tax held a hearing on the issue at

<sup>2</sup>PSC comments available at [http://www.pscouncil.org/PolicyIssues/SmallBusiness/SizeStandardsSetAsides/Comments\\_on\\_SBA\\_Prop.aspx](http://www.pscouncil.org/PolicyIssues/SmallBusiness/SizeStandardsSetAsides/Comments_on_SBA_Prop.aspx).

<sup>3</sup>The size standard for computer-related NAICS codes is currently set at \$27.5 million because SBA has made inflationary changes over the past several years.

which PSC provided testimony. Soon after, legislation was introduced by Representatives Joe Walsh and Gerry Connolly to restrict SBA's practice of relying on common size standards. The legislative proposal was ultimately adopted in Section 1661 of the fiscal year 2013 National Defense Authorization Act (NDAA). Unfortunately, the NDAA language was enacted after the SBA final rule changing the size standards for the "54 category" was complete and SBA has yet to take any action to address the reliance on common size standards in this category.

Thus, legitimate small businesses have been denied the ability to compete for set-aside contracts since the final rule went into effect in March 2012. An additional effect, and one that is being felt by a broader number of companies, is that companies have been denied the ability to increase their revenues while maintaining their small business size status. In the Computer Facilities Management Services category, for example, firms that were close to exceeding the \$25 million small business size standard in 2012 would have been able to grow their business to \$35.5 million while still being afforded the benefits that come with being a small business federal contractor. The added growth that the higher size standard would have provided to these companies could have eased their transition into the full and open competitive federal market. Instead, the result has likely been that businesses have either refrained from growth in order to maintain their small business status or they have had a tougher transition from their small business status because they are entering the full and open market much sooner than they would have if SBA had designated the appropriate size standard that their own methodology established.

Currently, SBA is required to update the individual size standards at least every five years. Although PSC believes rapidly evolving industries such as information technology and complex professional service should be reviewed more frequently, we understand the broad scope of SBA's responsibility to review all the size standards. We expect SBA to initiate and potentially complete a fresh review of the "54 category" within the next two years, and while SBA should not be allowed to ignore the law in the interim, we certainly look forward to SBA complying with Section 1661 of the fiscal year 2013 NDAA at that time.

#### Other Considerations

As mentioned above, SBA evaluated five major factors to determine the proposed size standards: average firm size; startup costs and entry barriers; industry competition; distribution of firms by size; and impact on federal contracting and SBA loan programs. SBA determined that each factor would be given equal weight in its calculations. However, PSC continues to recommend that greater weight be given to the "impact on federal contracting" factor. In addition, SBA should broaden its evaluation of the federal contracting market to examine if typical contract requirements under a specific category tend to gravitate toward larger contracts. If so, SBA might determine that a higher size standard is warranted. If typical requirements under a specific category seem better suited

to small contract awards, then perhaps a lower size standard would be more appropriate.

PSC further encourages SBA to reconsider the merits of adopting separate size standards for federal contracting. The adverse impact on small businesses of a single size standard that covers federal procurement and all other SBA programs is documented in SBA's own methodology. SBA acknowledges that the disparity between small business federal market share and industry-wide share may be attributed to a variety of reasons, such as extensive administrative and compliance requirements associated with federal procurement, the different skillsets required by federal contracts compared with typical commercial contracting work, and the size of specific contracting requirements of federal customers. Such a structure would allow SBA to focus more on the market dynamics regarding federal contracting and in turn make the size standards more reflective of the realities of the marketplace they so significantly impact.

PSC also recommends regular review of the NAICS codes themselves to ensure that they are properly aligned with the ever-changing dynamics within specific industries. Within the information technology space, for example, the emergence of new and much needed capabilities such as cybersecurity and cloud computing are significant. Yet these capabilities or offerings are lumped together with other computer-related industries under a limited number of computer-related NAICS codes, which does not reflect how industry is organized or how federal agencies acquire these goods and services. This recommendation is not intended to suggest that each new capability is deserving of its own NAICS code. Instead, it is merely intended to require regular review of the NAICS codes to ensure that, as industries evolve at an increasing pace, the NAICS codes are still appropriately structured.

Lastly, it is important to recognize that Section 1661 of the fiscal year 2013 NDAA is one of many small business contracting statutory provisions enacted since 2010. This subcommittee has been vigilant about holding SBA and the FAR Council accountable for implementing those provisions and PSC shares the frustration expressed at the recent subcommittee hearing about the length of time it has taken to complete implementation. As such, PSC supports efforts to move toward concurrent and collaborative SBA and FAR rulemaking to speed the implementation process. The need to implement these laws quickly is underscored by the fact that this year's House-passed NDAA also contains a number of small business provisions. It is simply unacceptable that implementation of those provisions, if enacted, and other previously enacted reforms, will take three or more years before they will be used in the federal contracting marketplace.

### Conclusion

PSC commends the Congressional action over the past several years to improve the size standard determination process. The enactment of Section 1661 is an important element of those reforms, and although it was enacted after work on the "54 category" of

NAICS codes was last revised, we look forward to SBA complying with the law promptly and certainly no later than their next substantive review of the Professional, Scientific and Technology Services sector. PSC also reiterates its support for an SBA size standard methodology that gives more weight to federal marketplace dynamics and creating a completely separate set of size standards to be used for federal procurement purposes only.

Mr. Chairman, this concludes my testimony. Again, thank you for inviting PSC to testify today and for your attention to this important issue. I would be happy to answer any questions.



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June 3, 2015

Chairman Steve Chabot  
Ranking Member Nydia Velazquez  
U.S. House of Representatives  
Committee on Small Business  
B343-C Rayburn Building  
Washington, DC 20515

Comments for the record for the House of Representatives Committee on Small Business hearing on the proposed Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade under Regulatory Information Number (RIN) 3245-AG51 NAICS 562910

Dear Mr. Chabot and Ms. Velazquez:

Engineering/Remediation Resources Group, Inc. (ERRG), a Small Business under the NAICS 562910, submits for the record our objection to the proposed size standard increase to the SBA's proposed change to the employee-based standard for the Environmental. We believe that an increase in the size standard from 500 to 1250 employees would actually decrease small business participation. The segment of businesses operating in this expanded size standard would lower overall competition as they would tend to dominate the market, gain considerable market share and push out current successful small businesses. Additionally, with a universe of emerging small businesses that do not currently operate under NAICS 562910, this expansion of the size standard would discourage businesses from entering and competing for government small businesses set-aside contracts as the market would be crowded with significantly larger players.

The market share for Remediation Services is a shrinking market with fewer federal dollars available each year. Increasing a size standard in a shrinking market appears counterproductive and against the mandate of the SBA to support the SB market place.

The current size standard and pool of contractors currently operating under this NAICS code are very capable of meeting the needs of the federal government at every level and virtually any contract type of remediation services.

The market for environmental remediation services, as presented in the SBA analysis is flawed through the use of business size data that does not represent the true status of the large businesses incorporated under NAICS 562910. Many if not most of the large business firms that represent the industry above the 500 personnel size category are multi-disciplinary and offer a broad range of services (NAICS) outside of the environmental remediation market. A more careful review of these larger firms would show revenue associated with NAICS 562910 to be a fraction of the total revenue represented and by association, a fraction of the total employee count. Compounding this misuse of data, the SBA has, in determining the size of the average firm under the ERS 562910 NAICS, employed the use of the mean of the data versus a

June 3, 2015  
Page 2



more representative median of the data. This analysis creates a skewed result shifting the size determination artificially to the right and thereby resulting in a much higher employee count than would be anticipated.

The federal government has ample competition and is getting excellent service from the small business community under NAICS 562910. This can be evidenced by the repeated use of small business set aside contracts, the competition garnered under these contracts and the increasing dollar value of small business contracts. All are evidence of a satisfied customer.

The small business community that falls within the 500 employee standard represents over 75% of the total number of businesses in NAICS 562910. This high percentage of firms supports the mission of the SBA providing opportunity to a significant segment of the total market participating under NAICS 562910. Finally, the underlying business driving NAICS 562910 has peaked in dollar volume and is in a declining period. Federal dollars targeted to this market decrease each year with long range plans showing a consistent and constant pattern of less revenue flowing through the environmental remediation NAICS. With this shrinking market, expansion of the size standard is counterintuitive and counterproductive to those firms that have dedicated resources to support the federal government as small businesses.

For the rationale stated above, we request that our position be entered into the record of the subject hearing.

Sincerely,

Brad Kordic  
Vice President

BJK/so



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November 6, 2014

United States Small Business Administration  
Attn: Mr. Khem R. Sharma, Ph.D, Chief, Size Standards Unit  
409 3rd Street, SW Mail Code 6530  
Washington, D.C. 20416

Subject: Comments on the proposed Small Business Size Standards: Industries with  
Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or  
Retail Trade under Regulatory Information Number (RIN) 3245--AG51  
NAICS 569210

Dear Mr. Sharma:

KEMRON Environmental Services, Inc. (KEMRON) submits our response to the SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services. KEMRON is opposed to this change and has provided our rationale for opposition herein.

An increase in the size standard, while opening the door for those businesses currently operating in the 500 to 1250 person sized firms, would actually decrease small business participation. The segment of businesses currently operating in this expanded size standard would lower overall competition as they would tend to dominate the market, gain considerable market share and push out current successful small businesses. Additionally, with a universe of emerging small businesses that do not currently operate under NAICS 562910, this proposed expansion of the size standard would discourage businesses from entering and competing for government small businesses set-aside contracts as the market would be crowded with significantly larger players.

As evidenced by KEMRON's success under NAICS 562910, a small business of less than 200 employees has supported the federal government under multiple USEPA contracts for emergency remediation response services, six concurrent USACE contracts, two nationwide Army contracts, three Navy contracts and two Air Force contracts. Total federal revenue over the past 5 years is approaching \$200M. Additionally, we have completed many performance based contracts with a total value over \$100M. These examples demonstrate the fact that the current size standard and pool of contractors included under the existing NAICS size standard are very capable of meeting the needs of the federal government at every level and virtually any contract type of remediation services.

This anecdotal information regarding KEMRON's performance under the 562910 NAICS code is provided to mitigate concerns expressed by firms represented by the gap between the current 500 person standard and the 1250 person proposed standard. KEMRON is by no means the only small business that has met and exceeded the expectations of our federal clients when providing the support services specified under this NAICS code. As will be evidenced by multiple letters submitted by other small business firms, our industry offers a robust number of well qualified firms providing the government with the services necessary to meet their individual environmental remediation requirements.

The market for environmental remediation services, as presented in the SBA analysis is flawed through the use of business size data that does not represent the true status of the large businesses incorporated under NAICS 562910. Many, if not most, of the large business firms that represent the industry above the 500 personnel size category are multi-disciplinary and offer a broad range of services outside of the environmental remediation market. A more careful review of these larger firms would show revenue associated with NAICS 562910 to be a fraction of the total revenue represented and by association, a fraction of the total employee count.

The federal government has ample competition and is getting excellent service from the small business community under the current size standard of 500 employees for NAICS 562910. This is substantiated by the repeated use of small business set aside contracts, the competition garnered under these contracts and the increasing dollar value of small business contracts. All are evidence of a satisfied customer. Specific to KEMRON's support to the USEPA we have been successful in gaining contract awards in Regions 2, 3, 4 and 5 for the Emergency and Rapid Response Services (ERRS) contracts. These contracts are used for everything from cleanup of abandoned contaminated sites to large full scale mobilization of response personnel to hurricanes and other natural disasters. USEPA has solicited this vitally important response contract from the small business community and has received excellent support and complete and comprehensive coverage for any and all requirements.

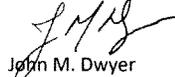
The small business community that falls within the 500 employee standard represents over 75% of the total number of businesses in NAICS 562910. This high percentage of firms supports the mission of the SBA providing opportunity to a significant segment of the total market participating under NAICS 562910. This percentage value represents well over 6000 firms providing the government with ample resources to complete agency specific mission while also ensuring adequate competition on every procurement. KEMRON's experience pursuing small business set aside contracts and MATOCs is an excellent example of the market conditions and capability within the market to support the federal government. Every MATOC procurement awarded to KEMRON in the last ten years has had considerable competition, generally having well over a dozen proposals for five awards. The fact that these contracts are competitive and more importantly that the government continues to use the capacity under these contracts and re-solicit for follow on small business contracts is further evidence that the current size standard as currently established is more than adequate.

Finally, the underlying business driving NAICS 569210 has peaked in dollar volume and is in a declining period. Federal dollars targeted to this market decrease each year with long range plans showing a consistent and constant pattern of less revenue flowing through the environmental remediation NAICS. With this shrinking market, expansion of the size standard is counterintuitive and counterproductive to those firms that have dedicated resources to support the federal government as small businesses.

For the rationale stated above, KEMRON respectfully requests that reconsideration of SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services. Should you have questions regarding this letter, please contact me at 404.601.6901 or via email ([jdwyer@kemron.com](mailto:jdwyer@kemron.com)).

Sincerely,

**KEMRON Environmental Services, Inc.**



John M. Dwyer  
Executive Vice President



TRANSMITTED VIA E-MAIL

June 3, 2015

Ms. Emily W. Murphy  
Senior Counsel  
House Small Business Committee  
2361 Rayburn HOB  
Washington DC 20515  
Emily.Murphy@mail.house.gov

SUBJECT: Comments For The Record  
House of Representatives Committee on Small Business  
Proposed Small Business Size Standards: Industries with Employee Based Size  
Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade under  
Regulatory Information Number (RIN) 3245-AG51 (NAICS 569210)

Dear Ms. Murphy:

**Nobis Engineering, Inc. (Nobis), a Small Business, and active Federal contractor submits for the record our strong objection to any proposed NAICS 562910 (remediation services) size standard increase.**

Nobis provided comments on the proposed revisions to 13 CFR Part 121 published in the Federal Register (Volume 79, No. 175) on September 10, 2014, with corrections published on October 20, 2014. The comments provided by Nobis focus specifically on the proposal to increase the employee-based size standard for North American Industry Classification System (NAICS) Code 562910 - Remediation Services.

Nobis is a small business, founded in 1988, with approximately 100 employees operating primarily in the Remediation Services marketplace for Federal Government clients. Over our 25-year history, Nobis has been celebrated as a small business success story, in large part due to a successful tenure in the United States Small Business Association (SBA) 8(a) business development program between 1995 and 2004. These opportunities provided to Nobis through the 8(a) program helped to strengthen our Federal Government qualifications so that in 2006, two years following our graduation from the program, we were selected in a competitive procurement (small business set-aside) as the prime contractor for a 10-year, \$100 million Response Action Contract (RAC) for the Environmental Protection Agency (EPA).

The EPA Region I RAC contract enabled Nobis to grow our business significantly and established us as a credible prime contractor for other 562910 small business set-aside opportunities. In fact, our growth trajectory and position in the Remediation Services industry is a story that SBA is proud to share with the small business community. In 2014, we were recognized by SBA as both **Massachusetts and National 8(a) Graduate Firm of the Year** ([link](#)). At our current size, we are extremely competitive as a small business in the remediation

Client-Focused, Employee-Owned  
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services industry, providing outstanding service to the Government, with plenty of room to grow within the existing small business size standard.

An increase in the size standard would have negative impacts on Nobis and many other small businesses of similar size and capability. Small businesses like ours that have benefited from various SBA programs, and who have been highlighted as SBA success stories, would struggle to compete with businesses 2.5 to 10 times larger, negating much of the progress we have made over the past couple of decades. Nobis Engineering is just one of many experienced small businesses in the 100+/- employee size range that truly specialize in Remediation Services (NAICS 562910) and have successfully competed for and executed this work for Federal agency clients. Even the 500-person size standard creates a challenging business climate for smaller Remediation Services firms like ours. Any increase above 500 would exacerbate this disadvantage, severely restricting access to large Remediation Services contracts by proven small business firms in the 100 to 200 employee range.

The SBA's FY2014-2018 Strategic Plan establishes the following three goals for the next five years: 1) grow business and create jobs, 2) serve as the voice for small business, and 3) build an Agency that meets the needs of today's and tomorrow's small businesses. Nobis believes the current employee-based size standard for NAICS 562910 is sized appropriately to enable achievement of these goals, and an increase in the size standard, given the nature of the Remediation Services market, would move SBA further from achieving these goals.

With these factors in mind, Nobis offers the following specific comments for SBA's consideration. We believe these comments demonstrate clearly that the current size standard is appropriate for the Remediation Services market and capable of supporting SBA's FY2014-2018 Strategic Plan. Some of our comments focus on the assumptions implicit in the SBA's methodology, while others provide facts to demonstrate that the current size standard is effective.

1. **Small business participation for NAICS 562910 is higher than SBA's small business contracting goal.** According to the SBA<sup>1</sup>, in 2013 small business participation in the Remediation Services market was 38.1 percent, far exceeding the SBA's contracting goal for small business of 23 percent. This is evidence that the 500-person size standard is not too restrictive to allow SBA to achieve their small business goals. This also provides clear evidence that small businesses are competitive in this industry, indicating a change in the size standard is not warranted.
2. **The Average Firm Size calculated for NAICS 562910 is not representative of the number of employees actually performing Remediation Services in the industry.** The SBA calculates simple average and weighted average firm sizes as part of the methodology for evaluating size standards. If the average firm size of an industry is significantly higher than the average firm size in the "anchor" comparison group, the SBA considers a size standard higher than the anchor.

The simple average firm size (48,022) and the weighted average firm size (20,583) for the Remediation Services industry are misleading in that larger firms engaged in this

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<sup>1</sup> Beale, Henry B. R. *Evaluation of the Small Business Procurement Goals Established in Section 15(g) of the Small Business Act*. June 2014 (<http://www.sba.gov/sites/default/files/files/rs423tot.pdf>).



industry tend to become multi-disciplinary as they grow. For example, many of the large firms included in the average size calculation for the Remediation Services industry also provide engineering, construction, and other services under multiple NAICS codes. Therefore, the average firm size used by SBA to evaluate whether the size standard should be adjusted is not necessarily representative of the number of employees actually performing Remediation Services.

In order to provide a more accurate comparison with which to evaluate the size standard, the average firm size should reflect the average number of employees actually performing Remediation Services. As currently constituted, the average firm size for the Remediation Services industry overestimates the actual size of the average firm, incorrectly suggesting that firms with fewer than 500 employees are not able to compete in the market, and therefore incorrectly suggesting that an increase in the size standard is warranted.

To base this evaluation on a more representative estimate of the "average" firm size in the Remediation Services industry, SBA might consider refining the list of firms or using a different statistic to represent the "average". A more detailed analysis of firms reporting a primary NAICS code of 562910 might reveal some different trends with respect to firm size in the industry. Alternatively, or possibly in addition, SBA might consider using the median value of firm sizes in its comparison to the anchor standard, which would mitigate the impact of very large firms, which skew the simple and weighted average calculations to the right.

3. **Environmental Remediation Services is a declining market.** As would be expected, most of the assumptions inherent in the SBA's methodology for re-evaluating small business size standards are based on the assumption that an industry is growing. However, the Remediation Services industry is an industry in decline. Most of the contaminated sites identified in the 1980s and 1990s have been remediated, and fewer new contaminated sites are being created due to the increased level of environmental awareness in our society, as well as strict environmental regulations. As a result, spending on environmental remediation has slowed, and the industry is shrinking. According to data extracted from USASpending.gov, Federal dollars obligated to contracts under the 562910 code has decreased from \$4.66 billion in 2010 to \$4.12 billion in 2013.

The Department of Defense (DoD), one of the largest Government purchasers of Remediation Services, is winding down their Defense Environmental Restoration Program (DERP), establishing a goal of 90 percent "Remedy Complete" for all Installation Restoration Program (IRP) sites by the end of FY2018. As of FY2013, DoD was reporting that 77 percent of the 38,804 sites in the DERP have achieved Remedy Complete, with another 5 percent having achieved Remedy in Place. The DoD's projections for spending on environmental restoration provide even more evidence of the declining market for Remediation Services: FY2013 spending was projected at approximately \$1.80 billion, FY2014 at \$1.77 billion, and FY2015 at \$1.37 billion<sup>2</sup>.

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<sup>2</sup> Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics. *Defense Environmental Programs Annual Report to Congress for FY 2013*. June 2014 (<http://www.denix.osd.mil/arc/ARCFY2013.cfm>).



EPA spending on the Remediation Services industry follows a similar trend. According to information extracted from the GovWin® government procurement database, EPA contract obligations decreased from approximately \$570.5 million in FY2011 to \$469.4 million in FY2013.

These trends in the Remediation Services industry should be considered in the re-evaluation of the small business size standard. While the metrics typically used by SBA to adjust size standards may suggest an increase in the employee-based standard for this industry, clearly the market trends do not justify an increase in the standard.

In summary, Nobis is submitting comments **in opposition to the proposed increase** in the employee-based small business size standard for NAICS 562910 from 500 to 1,250. Small business participation in the Remediation Services market exceeds SBA's goals, indicating that the current size standard is effective and small businesses are competitive in this market. Also, there is a declining market for Remediation Services and many of the large firms participating in the market are multi-disciplinary, two factors that suggest the methodology for re-evaluating this size standard should be reconsidered to ensure the needs of true small businesses are met today and into the future.

Thank you for your consideration of our comments.

Respectfully,

A handwritten signature in black ink, appearing to read "Peter W. Delano".

Peter W. Delano, P.E.  
Senior Vice President, Nobis Engineering, Inc.

4 June 2015

The Honorable Nydia Velazquez  
Ranking Member, Small Business Committee  
US House of Representatives  
2302 Rayburn House Office Building  
Washington, DC 20515

And

The Honorable Steve Chabot  
Chairman, Small Business Committee  
US House of Representatives  
2371 Rayburn House Office Building  
Washington, DC 20515

**SUBJECT: *Comments for the record for the House of Representatives Committee on Small Business hearing on the proposed Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade under Regulatory Information Number (RIN) 3245-AG51 NAICS 562910***

Dear Ranking Member Velazquez and Chairman Chabot:

The small business community representing government contractors under the NAICS 562910 submits for the record our objection to the proposed size standard increase to the SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services. The businesses represented as shown by the signatures on this submittal are opposed to this change and provide our rationale for opposition herein.

An increase in the size standard, while opening the door for those businesses currently operating in the 500 to 1250 person sized firms, would actually decrease small business participation. The segment of businesses operating in this expanded size standard would lower overall competition as they would tend to dominate the market, gain considerable market share and push out current successful small businesses. Additionally, with a universe of emerging small businesses that do not currently operate under NAICS 562910, this expansion of the size standard would discourage businesses from entering and competing for government small businesses set-aside contracts as the market would be crowded with significantly larger players.

The market share for Remediation Services is a shrinking market with fewer federal dollars available each year. Increasing a size standard in a shrinking market appears counterproductive and against the mandate of the SBA to support the SB market place.

The current size standard and pool of contractors currently operating under this NAICS code are very capable of meeting the needs of the federal government at every level and virtually any contract type of remediation services.

The market for environmental remediation services, as presented in the SBA analysis, is flawed through the use of business size data that does not represent the true status of the large

**Comments for the Record**  
**4 June 2015**  
**Page 2**

businesses incorporated under NAICS 562910. Many, if not most, of the large business firms that represent the industry above the 500 personnel size category are multi-disciplinary and offer a broad range of services (NAICS) outside of the environmental remediation market. A more careful review of these larger firms would show revenue associated with NAICS 562910 to be a fraction of the total revenue represented and by association, a fraction of the total employee count. Compounding this misuse of data, the SBA has, in determining the size of the average firm under the ERS 562910 NAICS, employed the use of the mean of the data versus a more representative median of the data. This analysis creates a skewed result shifting the size determination artificially to the right and thereby resulting in a much higher employee count than would be anticipated.

The federal government has ample competition and is getting excellent service from the small business community under NAICS 562910. This can be evidenced by the repeated use of small business set aside contracts, the competition garnered under these contracts and the increasing dollar value of small business contracts. All are evidence of a satisfied customer.

The small business community that falls within the 500 employee standard represents over 75% of the total number of businesses in NAICS 562910. This high percentage of firms supports the mission of the SBA providing opportunity to a significant segment of the total market participating under NAICS 562910. Finally, the underlying business driving NAICS 562910 has peaked in dollar volume and is in a declining period. Federal dollars targeted to this market decrease each year with long range plans showing a consistent and constant pattern of less revenue flowing through the environmental remediation NAICS. With this shrinking market, expansion of the size standard is counterintuitive and counterproductive to those firms that have dedicated resources to support the federal government as small businesses.

For the rationale stated above, we the signatories of this letter request that our position be entered into the record of the subject hearing.

Sincerely,

**The 562910 Small Business Community**



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Comments for the Record  
4 June 2015  
Page 3



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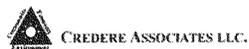
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Comments for the Record  
4 June 2015  
Page 4



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June 3, 2015

Ms. Eminence Northcutt, Procurement Counsel  
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Committee on Small Business  
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Washington, DC 20515  
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And

Ms. Emily W. Murphy  
Senior Counsel  
House Small Business Committee  
2361 Rayburn HOB  
Washington DC 20515  
[Emily.Murphy@mail.house.gov](mailto:Emily.Murphy@mail.house.gov)

**SUBJECT:** *Comments for the record for the House of Representatives Committee on Small Business hearing on the proposed Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade under Regulatory Information Number (RIN) 3245-AG51 NAICS 569210*

Sovereign Consulting Inc. (Sovereign) submits for the record our objection to the proposed size standard increase to the SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services.

Sovereign, an environmental remediation company, appreciates the opportunity to provide comments for the record on the Small Business Administration's (SBA) Proposed Rule pertaining to employee-based small business size standards and the proposed size increase. Sovereign graduated from the SBA 8(a) Business Development program in March 2010 and entered into the Total Small Business size standard categorized under the Environmental Remediation Services (ERS) Sub-Industry ("Exception under 500 employees") for NAICS Sector 562910, Remediation Services. SBA's proposal to increase the current size standard for the ERS Sub-Industry Sector from 500 employees to 1,250 employees is of concern to Sovereign, a firm of approximately 165 personnel and \$40M in annual revenue.

An increase in the size standard, while opening the door for those businesses currently operating in the 500 to 1250 person sized firms, would actually decrease small business participation. The segment of businesses operating in this expanded size standard would lower overall competition as they would tend to dominate the market, gain considerable market share and push out current successful small businesses. Additionally, with a universe of emerging small businesses that do not currently operate under NAICS 562910, this expansion of the size standard would discourage businesses from entering and competing for government small businesses set-aside contracts as the market would be crowded with significantly larger players.



The Small Business Jobs Act of 2010 includes the objective of ensuring that small businesses receive a "fair share" of federal contracting opportunities. Sovereign agrees that the size standards should reflect the current marketplace; however, an increase of this magnitude is unnecessary, and we call into question the analytical methodology and source data used to support SBA's size standard decision for the ERS sub-industry "exception." Our concern is premised on our experience operating in the federal contracting marketplace and competing as a small business with 165 employees and \$40M in revenue. Businesses with less than 1,250 employees have revenues in excess of \$200M giving them significant advantages and resources in competing in the federal marketplace against companies with under 500 employees. In addition, the increase would limit subcontracting opportunities from Large Businesses to current small businesses therefore decreasing the available amount of work with firms under 500 employees.

The market for Remediation Services is a shrinking market with fewer federal dollars available each year. Increasing a size standard in a shrinking market appears counterproductive and against the mandate of the SBA to support the SB market place.

The current size standard and pool of contractors currently operating under this NAICS code are very capable of meeting the needs of the federal government at every level and virtually any contract type of remediation services. According to Federal Procurement Data System - Next Generation (FPDS-NG), there are more than 710 small business firms with fewer than 500 personnel that were awarded prime contracts supporting the US government's ERS. The existing size standard of fewer than 500 employees works and creates adequate competition in the marketplace. Sovereign is a successful small business in NAICS 562910, as demonstrated by our award of more than \$60M in ERS Contracts. USASpending.gov's percentage of small business participation in NAICS 562910 is trending to a rise, which is indicative of the capability of the firms with less than 500 employees to successfully compete for and execute ERS, even in a shrinking market. FPDS-NG data show that in FY13 \$4B was awarded under more than 2,000 contract actions for Environmental Remediation Services. Approximately half the funds (\$1.8B) were awarded to small businesses and more than half the contract actions (1,280) were for small businesses.

The market for environmental remediation services, as presented in the SBA analysis is flawed through the use of business size data that does not represent the true status of the large businesses incorporated under NAICS 562910. Many if not most of the large business firms that represent the industry above the 500 personnel size category are multi-disciplinary and offer a broad range of services (NAICS) outside of the environmental remediation market. A more careful review of these larger firms would show revenue associated with NAICS 562910 to be a fraction of the total revenue represented and by association, a fraction of the total employee count. Compounding this misuse of data, the SBA has, in determining the size of the average firm under the ERS 562910 NAICS, employed the use of the mean of the data versus a more representative median of the data. This analysis creates a skewed result shifting the size determination artificially to the right and thereby resulting in a much higher employee count than would be anticipated.

The federal government has ample competition and is getting excellent service from the small business community under NAICS 562910. This can be evidenced by the repeated use of small business set aside contracts, the competition garnered under these contracts and the increasing dollar value of small business contracts. All are evidence of a satisfied customer.



The small business community that falls within the 500 employee standard represents over 75% of the total number of businesses in NAICS 562910. This high percentage of firms supports the mission of the SBA providing opportunity to a significant segment of the total market participating under NAICS 562910. Finally, the underlying business driving NAICS 562910 has peaked in dollar volume and is in a declining period. Federal dollars targeted to this market decrease each year with long range plans showing a consistent and constant pattern of less revenue flowing through the environmental remediation NAICS. With this shrinking market, expansion of the size standard is counterintuitive and counterproductive to those firms that have dedicated resources to support the federal government as small businesses.

#### **Conclusion**

The result of the proposed modification to the Environmental Remediation Services Sub-Industry ("Exception") Under NAICS 562910, Remediation Services, will have a negative impact to those below the current size standard (under 500 employees) who are arguably the very businesses that need the most assistance to successfully compete in this sector of the federal marketplace. The larger small businesses (500-1,250 employees) have significantly more resources, and are more sustainable. Regardless of the indexes used to calculate the increase of the standard over time, it is an unreasonable expectation that the small businesses (under 500 employees) can compete effectively against firms that are up to 2 ½ times their size in this sector. It will have an immediate impact on the smaller businesses' competitiveness, and will have the likely result of fewer of these smaller businesses competing on federal procurements.

Sovereign believes there are data gaps in the presented decision-making process due to the data not being current or sufficiently comprehensive in presenting an accurate depiction of the current industry, including downward trending of the ERS market size (number and size of projects), growing industry competition with the existing size standard, outstanding performance by firms within the existing size standard, trending increase in the number of participating firms, the "average" firm profile (i.e., revenues and number of employees) within a firm performing ERS, and distribution of firms by size within the ERS subcategory.

Again, Sovereign Consulting is opposed to the size increase and strongly recommends the House of Representatives Committee on Small Business and SBA review its decision-making methodology and source data; and, recommends utilizing an independent company to conduct a more thorough analysis of the ERS industry and NAICS Sector 562910.

Sincerely,  
SOVEREIGN CONSULTING INC.

A handwritten signature in black ink, appearing to read "Marc Cicalese".

Marc Cicalese  
Principal

June 3, 2015



Ms. Eminence Northcutt, Procurement Counsel  
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**SUBJECT:** *Comments for the record for the House of Representatives Committee on Small Business hearing on the proposed Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade under Regulatory Information Number (RIN) 3245-AG51 NAICS 562910*

DEAR MS. NORTHCUTT AND MS. MURPHY:

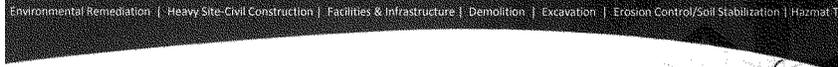
The small business community representing government contractors under the NAICS 562910 submits for the record our objection to the proposed size standard increase to the SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services. The businesses represented as shown by the signatures on this submittal are opposed to this change and provide our rationale for opposition herein.

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Compounding this misuse of data, the SBA has, in determining the size of the average firm under the ERS 562910 NAICS, employed the use of the mean of the data versus a more representative median of the data. This analysis creates a skewed result shifting the size determination artificially to the right and thereby resulting in a much higher employee count than would be anticipated.

The federal government has ample competition and is getting excellent service from the small business community under NAICS 562910. This can be evidenced by the repeated use of small business set aside contracts, the competition garnered under these contracts and the increasing dollar value of small business contracts. All are evidence of a satisfied customer.

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For the rationale stated above, we the signatories of this letter request that our position be entered into the record of the subject hearing.

Sincerely,  
TANTARA Corporation

Dawn Dearborn, President  
SAME Boston Post Small Business Committee Chair (2013-2014)  
SAME Boston Post Spring Meeting Committee Chair (Current)

## ***USA Environmental, Inc.***

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June 3, 2015

USA-NAICS-JC-0001

Honorable Nydia Velazquez Ranking Member  
House Small Business Committee  
B-343C Rayburn HOB  
Washington DC 20515  
[Nydia.Velazquez@mail.house.gov](mailto:Nydia.Velazquez@mail.house.gov)

**SUBJECT:** Comments for the record for the House of Representatives Committee on Small Business hearing on the proposed Small Business Size Standards: Industries with Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade under Regulatory Information Number (RIN) 3245-AG51 NAICS 562910

Dear Ms. Velazquez,

As a member of the small business community representing government contractors under the NAICS 569210, I respectfully submit for the record my objection to the proposed size standard increase to the SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services.

An increase in the size standard, while opening the door for those businesses currently operating in the 500 to 1250 person sized firms would actually decrease small business participation. The segment of businesses operating in this expanded size standard would lower overall competition as they would tend to dominate the market, gain considerable market share and push out current successful small businesses. Additionally, with a universe of emerging small businesses that do not currently operate under NAICS 562910, this expansion of the size standard would discourage businesses from entering and competing for government small businesses set-aside contracts as the market would be crowded with significantly larger players.

The market share for Remediation Services is a shrinking market with fewer federal dollars available each year. Increasing a size standard in a shrinking market appears counterproductive and against the mandate of the SBA to support the SB market place.

The current size standard and pool of contractors currently operating under this NAICS code are very capable of meeting the needs of the federal government at every level and virtually any contract type of remediation services.

The market for environmental remediation services, as presented in the SBA analysis is flawed through the use of business size data that does not represent the true status of the large businesses incorporated under NAICS 562910. Many if not most of the large business firms that represent the industry above the 500 personnel size category are multi-disciplinary and

offer a broad range of services (NAICS) outside of the environmental remediation market. A more careful review of these larger firms would show revenue associated with NAICS 562910 to be a fraction of the total revenue represented and by association, a fraction of the total employee count. Compounding this misuse of data, the SBA has, in determining the size of the average firm under the ERS 569210 NAICS, employed the use of the mean of the data versus a more representative median of the data. This analysis creates a skewed result shifting the size determination artificially to the right and thereby resulting in a much higher employee count than would be anticipated.

The federal government has ample competition and is getting excellent service from the small business community under NAICS 562910. This can be evidenced by the repeated use of small business set aside contracts, the competition garnered under these contracts and the increasing dollar value of small business contracts. All are evidence of a satisfied customer.

The small business community that falls within the 500 employee standard represents over 75% of the total number of businesses in NAICS 562910. This high percentage of firms supports the mission of the SBA providing opportunity to a significant segment of the total market participating under NAICS 562910. Finally, the underlying business driving NAICS 562910 has peaked in dollar volume and is in a declining period. Federal dollars targeted to this market decrease each year with long range plans showing a consistent and constant pattern of less revenue flowing through the environmental remediation NAICS. With this shrinking market, expansion of the size standard is counterintuitive and counterproductive to those firms that have dedicated resources to support the federal government as small businesses.

For the rationale stated above, I am respectfully requesting that my position be entered into the record of the subject hearing.

Sincerely,



Jonathan Chionchio  
President

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Environmental  
Infrastructure  
Buildings & Facilities

June 3, 2015

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As a member of the small business community representing government contractors under the NAICS 562910 we submit for the record our objection to the proposed size standard increase to the SBA's proposed change to the employee-based standard for the Environmental Remediation Services Sub-Industry ("Exception") under NAICS 562910, Remediation Services. We are opposed to this change and provide our rationale for opposition herein.

An increase in the size standard, while opening the door for those businesses currently operating in the 500 to 1250 person sized firms would actually decrease small business participation. The segment of businesses operating in this expanded size standard would lower overall competition as they would tend to dominate the market, gain considerable market share and push out current successful small businesses. Additionally, with a universe of emerging small businesses that do not currently operate under NAICS 562910, this expansion of the size standard would discourage businesses from entering and competing for government small businesses set-aside contracts as the market would be crowded with significantly larger players.

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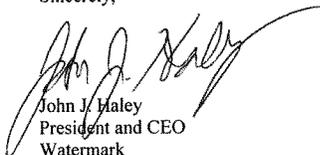


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For the rationale stated above, we request that our position, as opposed, be entered into the record of the subject hearing.

Sincerely,



John J. Haley  
President and CEO  
Watermark