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“Eliminate Most DoD Small Business Set-Asides,” Says Section 809 Panel

The Section 809 Panel has recommended that Congress eliminate most small business set-asides for DoD acquisitions. The Panel would replace the longstanding set-aside system with a meager five percent small business price preference.

For small government contractors, this recommendation is the policy equivalent of a five-alarm fire. Small contractors may need to fight hard to save the set-aside system.

Get ready for a battle.

The Government’s Longstanding Small Business Policy

The United States Government has long supported small contractors. Policymakers wisely understand that providing contracting opportunities to small businesses isn’t just good for those businesses, but benefits the nation as a whole. Here’s how that longstanding policy is described in the Small Business Act itself, at [15 U.S.C. 631](#):

The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Govern-

ment should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government (including but not limited to contracts or subcontracts for maintenance, repair, and construction) be placed with small-business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation.

For more than 30 years, this vital policy has been implemented in the FAR by way of the “rule of two,” which requires Contracting Officers to set aside competitions for small businesses (or socioeconomic subcategories of small businesses, like SDVOSBs) under certain circumstances.

In its current form, the rule of two under [FAR 19.502-2](#) has two components, which are rather similar.

There is a strong policy of set-asides for purchases (except micro-purchases) under the simplified acquisition threshold. For those procurements, the FAR says:

[Each such acquisition] is automatically reserved exclusively for small business concerns and shall be set aside for small business unless the contracting officer determines there is not a reasonable expectation of obtaining offers from two or more responsible small business concerns that are competitive in terms of market prices, quality, and delivery.

A slightly different standard applies to acquisitions over the threshold. In those cases, the Contracting Officer generally is required to use a set-aside when there is a “reasonable expectation” of receiving offers from “two responsible small business concerns” and “award will be made at fair and reasonable prices.”

Responsibility, of course, is the question of whether an offeror is capable of performing a contract. As set forth in [FAR Part 9](#), responsibility encompasses things such as whether the offeror has adequate financial resources, experience, operational controls, technical skill, facilities, and equipment. Because the rule of two only applies when two *responsible* offerors are likely to submit bids, Contracting Officers need not issue set-asides when they aren’t comfortable that they’ll receive at least two reasonably-priced offers from small businesses meeting these standards.

Contracting Officers have a great deal of latitude when it comes to applying the FAR rule of two. As the [GAO has written](#), a set-aside determination “is basically a business judgment within the broad discretion of the contracting officer.”

Contracting Officers also have ways of avoiding the rule of two entirely. For instance, while small business set-asides are allowed under GSA Schedules, they [aren’t required](#). Unlike the VA’s separate SDVOSB rule of two, which was the subject of the [Supreme Court’s famous *Kingdomware* case](#), a Contracting Officer need not apply the FAR’s small business rule of two before buying off the Schedule. Additionally, the [GAO has held](#) that Contracting Officers need not apply the rule of two when soliciting orders under unrestricted multiple-award contracts, like the Air Force’s large NETCENTS-2 vehicle.

The bottom line? Under the FAR, small business set-asides are preferred no matter the dollar value, but Contracting Officers have a great deal of flexibility. If a particular Contracting Officer isn’t satisfied with the potential pool of small business offerors, he or she is unlikely to be forced to issue a set-aside solicitation.

The Section 809 Panel’s Shocking Proposal

That brings us back to the Section 809 Panel’s shocking proposal.

When I first heard of the Section 809 Panel, my immediate reaction was “uh-oh.” After all, the Panel [touts its mission](#) as “identifying ways to streamline and improve the defense acquisition system,” among other things.

To me, “streamline” is one of those loaded terms (like “strategic sourcing,” “consolidation,” and “category management”) that never seem to work out too well for small businesses. If an organization views its mission as streamlining, there’s a pretty good chance that it will see a policy like the rule of two as red tape, rather than a fundamental building block of a broad and robust industrial base.

Through its first two reports, the Section 809 Panel didn’t seem to be doing too badly when it came to small business recommendations. I was starting to hope that small contractors might make it through the Panel’s process without too much trouble.

Then came [Volume III](#).

The third and final volume clocks in at a whopping 1,120 pages, not including a separate “Summary of Recommendations.” (I continue to be mildly amused by the irony of a “streamlining” panel putting out [Tolstoy-length](#) reports).

The Section 809 Panel summarizes the FAR small business set-aside rules this way:

All procurements below simplified acquisition threshold (SAT) are 100% set-aside for small business; rule of two still applies above the threshold.

Then, the Section 809 Panel claims that small business set-asides actually *hurt* small businesses:

Set-asides and other small business programs incent [sic] small businesses to make extraordinary efforts to remain small. Setting-aside all procurements under a certain dollar threshold does not encourage a small business to grow beyond that threshold, especially if that business relies on competing for procurements that are currently set

aside for small business. Outgrowing the size standard makes those businesses ineligible to compete for the same contracts that, in many cases, were critical to the success of the small business.

As evidence of the “extraordinary efforts,” the Section 809 Panel cites . . . its own [Volume I Report](#)! That’s like me claiming to be the best-looking government contracts lawyer in the country, and citing an email I wrote to myself as proof.

Anyway, getting back to Volume III, the Panel proposes that, for most DoD acquisitions (those classified as “readily available” or “readily available with customization”), small business set-asides would be replaced with a five percent small business price preference. The Panel says:

Using a price preference and requiring DoD to continue to meet the overarching small business use goal established by SBA will ensure the same amount of DoD dollars are invested in small business, while allowing capable small businesses to grow and compete for opportunities.

Oh goody! A whopping five percent price preference! I’m sure that will make all the difference when I’m competing directly against Microsoft for that IT staffing project.

The Problems with the Section 809 Panel’s Shocking Proposal

If you’re something of an astute reader, you may have picked up on the fact that I’m not particularly wild about the proposal to replace small business set-asides with a five percent price preference. And by “not particularly wild,” I mean that this may be the single worst government contracting idea I’ve ever seen.

Why, you ask? (It’s so nice of you to ask! Next, please send me an email saying I’m the country’s best-looking government contracts lawyer!)

Let’s discuss.

First, the Section 809 Panel begins by misstating the current small business set-aside rules. No, Panel, not “all procurements” under the simplified acquisition threshold are 100% set-aside for small businesses. Likewise, the rule of two doesn’t apply to all procurements over the SAT.

What about fair pricing? Responsibility? GSA Schedule contracts? Unrestricted IDIQs? Contracting Officer discretion? Nope, nope, nope, nope and nope. The Panel doesn’t mention any of it.

The Section 809 Panel is composed of [many smart, experienced people](#). They must know that the small business set-aside rules are nuanced. But instead of mentioning that nuance in the report, the Panel gives readers the impression that big, bad FAR 19.502-2 is grim and unyielding, regularly forcing beleaguered DoD Contracting Officers into ill-advised set-asides.

Members of Congress are, by necessity, jacks of all trades. They don’t necessarily have the depth of knowledge about federal contracting to understand that the Panel’s statement of the set-aside law is incomplete at best. It’s quite possible that policymakers will read Volume III and come away thinking, “wow, every single procurement under the simplified acquisition threshold goes to small businesses, no matter what? That seems excessive!” And they’d be right, were that actually the way it worked. But it’s not.

Second, the Section 809 Panel says that businesses make “extraordinary efforts” to remain small, and that offering set-asides doesn’t encourage growth beyond certain size standards.

Now, there’s a nugget of truth here: while many contractors (including many of our firm’s clients) embrace growth above their small business size standards, some businesses do, indeed, choose to remain small rather than try their luck competing against Lockheed, Boeing and their ilk. But most of those businesses *wouldn’t have grown close to the size standard in the first place* were it not for set-asides.

Sure, an IT company could run into trouble competing against Microsoft and Google, even after the IT company has exceeded the \$27.5 million size standard under NAICS codes like 541511 (Custom Computer Programming Services). A company in that position might choose to remain small, or it might embrace its growth and prepare to compete against the big boys. But how would that company have fared against Google when the company was a \$1 million or \$2 million entity?

It seems crazy that I have to say it, but set-asides *help* small businesses, by creating a special pool where those companies can grow and develop while avoiding direct competition against multi-billion dollar behemoths. If we eliminate set-asides, why would a \$1 million company even attempt to enter the Government market?

Notably, the Section 809 Panel doesn't seem to have asked any actual small businesses or small business advocates about its plan. Are small businesses really clamoring for the elimination of those pesky set-asides? Do small businesses, or small business advocates like the SBA, really think that set-asides hurt small businesses? I can't help but wonder if the reason the Section 809 Panel doesn't seem to have asked is because the Panel already knows the answer.

It's unfortunate when businesses outgrow their size standards and can no longer compete for re-compete of contracts they've successfully performed, but eliminating set-asides isn't the answer. Doing so will simply ensure that many businesses never get to this tipping point in the first place.

Third, the proposal to replace set-asides with a five percent price preference is woefully inadequate to ensure that small businesses continue to receive a fair proportion of government contracts.

To understand whether price preferences are sufficient to ensure that DoD meets its small business goals, we can simply look at the HUBZone Program. For years, HUBZone firms have been entitled to a [10 percent price preference](#) when they compete against large firms.

The HUBZone price preference works by requiring the Contracting Officer to pretend, for evaluation purposes, that the prices offered by large businesses are 10 percent higher. For example, if a large business proposes a price of \$10 million, the agency would pretend that the price was \$11 million. But if the agency awards the contract to the large business, the agency pays the “real” price: \$10 million.

In a lowest-price, technically-acceptable evaluation, the HUBZone price preference can make a difference. In the example above, if the solicitation was issued on an LPTA basis, and a technically acceptable HUBZone firm proposed a price of, say, \$10.5 million, the HUBZone company would get the contract.

In recent years, though, Congress has [dramatically curtailed the use of lowest-price technically acceptable evaluation schemes](#), meaning that price is rarely going to be the sole deciding factor in a DoD acquisition. And in the context of a best value procurement, I can't recall a single instance in my career in which the HUBZone price preference determined the outcome.

Contracting Officers are human beings, after all. And it takes a special human being to say, “yep, I know the large business was a little better technically, has more past performance, and proposed the lower ‘real’ price, but to heck with it—I’m going with the HUBZone based on the pretend price, even though the Government will actually pay more.”

Further, although many Contracting Officers support small businesses as a general principal, Contracting Officers (unsurprisingly) tend to care most about getting a project done right. Faced with a choice between, say, Google, on the one hand, and a smart, creative, tenacious, up-and-coming HUBZone firm on the other, how many Contracting Officers will simply opt for the “safe” choice and go with the brand name?

Then there's the math. If the HUBZone price preference was truly effective at ensuring that DoD met its HUBZone goals, one would expect that the numbers would show it. But, like the Government as a whole, DoD has fallen way short. In [Fiscal Year 2017](#), the DoD “achieved” just 1.56% for HUBZones, versus a 3% goal.

Keep in mind that the 1.56% “achievement” occurred even though the FAR includes a 10 percent HUBZone price preference *plus* provisions allowing for HUBZone set-asides and sole source contracts. If DoD can barely reach half of its HUBZone goal given these tools, why on earth would anyone think that a five percent price preference, with no set-asides, would be enough to ensure achievement of the small business goals?

Fourth, speaking of goals, the Section 809 Panel is wrong to say that “requiring DoD to continue to meet the overarching small business use goal established by SBA will ensure the same amount of DoD dollars are invested in small business.”

No agency, including DoD, is “required” to meet SBA goaling requirements. The goals are just that: goals. If an agency doesn’t meet its goals, the agency might get a slightly lower grade on the SBA’s annual report card, but that’s it. (And even the lower grade is unlikely given the SBA’s [tendency toward grade inflation: DoD got an “A” for Fiscal Year 2017](#) despite missing its WOSB and aforementioned HUBZone goals.)

By the way, DoD exceeded its 22% small business goal in FY 2017, [but not by much, at 23.26%](#). More than three-quarters of DoD’s prime contracting dollars already go to large businesses. These numbers don’t exactly suggest that DoD Contracting Officers are struggling with the rule of two.

And if DoD can only muster 23.26% now, is it really going to continue meeting its small business goal if we eliminate set-asides? Count me as skeptical.

Bold—or Bold and Stupid?

The Section 809 Panel says that its proposal is for “bold changes, which will not be welcomed by those who benefit from the idiosyncrasies of the existing system and those who view this proposed approach as an abandonment of socioeconomic and domestic preference programs.”

This sort of self-congratulatory rhetoric permeates the Volume III Report. The Section 809 Panel repeatedly casts itself as bold and revolutionary, and tries to preemptively tar anyone who dares to disagree as a behind-the-times proponent of “idiosyncrasies.”

Don’t be fooled.

[Riding a jetski over Niagra Falls](#) is bold, but stupid. Same with [trying to take selfies with wild elephants](#), or [driving on a state highway in a golf cart towed by a garden hose](#). The Section 809 Panel’s ideas on small business set-asides may be bold, but that doesn’t make them good ideas.

The Panel says, “these recommendations would achieve the goal of allowing DoD to behave the way buyers in the private sector behave.” But the Government isn’t the private sector. Unlike the private sector, which is narrowly responsible to its investors and customers, the Government has much broader obligations to the taxpayers and nation as a whole.

Do we really want the Government to behave like a private company? A private company isn't worried about growing a broad industrial base. A private company isn't concerned about supporting the broader economy, expanding competition, or promoting any of the other important social and public policies that are part of the fabric of the nation. A private company isn't subject to the same ethics rules: it may be perfectly fine, at a private company, if the CEO decides to award a subcontract to his golf buddy, or if a customer takes the entire Board of Directors on an Aspen ski trip to try to close the deal.

Government should be different: different in its societal role, different in its priorities, different in the ethical standards to which it holds itself and its employees. While there's nothing wrong with looking to the private sector for procurement ideas, there's everything wrong with treating private industry as the gold standard, and Government as though it's just another private buyer.

Sorry, Panel, but the longstanding small business preferences set forth in the FAR aren't “idiosyncrasies.” They're the essential underpinning of a procurement system that is designed to do much more than merely copy the habits of for-profit businesses, regardless of whether those habits make sense when the buyer is the Government.

The Section 809 Panel was convened by Congress, so there's little doubt that the Panel's recommendations will be taken seriously—and little doubt that many large contractors will seize the opportunity to push for, as the Panel puts it, “abandonment” of the small business programs.

Small businesses better gear up for a fight.