

Phony Federal Subcontracting Program Revealed in Sikorsky Case

By Professor Charles Tiefer

Thank you for the opportunity to express my opinion on the subject of the Comprehensive Subcontracting Plan Test Program, namely that the program is conducted in a phony way. A lawsuit by the American Small Business League (ASBL), heading for trial is suggesting that a Defense Department program intended to promote small business subcontracting well be conducted in a spurious way.

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Current Developments

Discovery in the lawsuit -- against the Defense Department and Sikorsky, a major helicopter maker -- has suggested that major defense contractors manipulate data to falsely claim they meet their small business subcontracting targets. The program fails over its lifetime to provide promised small business subcontracting on hundreds of billions of federal contracting dollars. Small business would lose out on the opportunities that Congress and the public want small business to get.

The ASBL, and its president Lloyd Chapman, seeks the program's records under the Freedom of Information Act (FOIA). Ahead of the trial this December, ASBL has obtained discovery and depositions about Sikorsky's defense contracting.

The ASBL discovery and other information point to one way contractors evade their subcontracting obligations.

A prime contractor may commit to the government to meet a goal of, say, 30% of its subcontracting will go to small business. And, it may report that it did so in the first half of 2017.

What the contractor does, may be termed a sham pass-through. The prime contractor picks out some large contractors to which it wishes to subcontract important products for installation in its helicopters, planes, or other products for its prime contract. Then the prime contractor gets a small company to agree for some nominal fee (like 1%) to "buy" the product from the large contractor, and then turn around, without doing any work, and "sell" the product to the prime contractor. All the small company has to do is sign a contract and some receipts.

The prime contractor then lists the full percentage of products bought through such sham pass-throughs as qualifying to be subcontracting to small business.

In fact, the prime contractor can take this one phony step further. The small company chosen as the sham pass-through may qualify as one of the specialized kinds of small business that have special federal assistance programs, like women-owned small business or service-disabled veteran-owned small business. In that case, the prime contractor may have the cheek to count the phony small business subcontracting as the compliance with its duties for those special federal assistance programs.

Where does the Defense Department program, traditionally known as the “Comprehensive Subcontracting Plan Test Program,” come in?

Again, the ASBL discovery and other information suggest the Test Program reduces the specificity and transparency of large contractor reporting of asserted small business subcontracting. This, in turn, emboldens the large contractors to conduct a phony system. For example, much of Sikorsky’s sales to the government are sole-source, meaning Sikorsky has no competitors. Sole-sourcing means Sikorsky has no legitimate fear that disclosing its small business subcontracting figures for the sole-sourced products would give an advantage to its (non-existent) competitors. Yet, Sikorsky has tried to keep its information secret, conveniently veiling its dubious claims about its asserted small-business subcontracting.

Under the program, large contractors need not plan or report on individual contracts. They just create a vague overall plan for their nationwide contracting. With so little

transparency, the small business subcontracting may only occur on a sham basis, if that small business subcontracting occurs at all.

Background

The government has a very important Small Business Subcontracting Program pursuant to Federal Acquisition Regular (FAR) 19.7 and 15 U.S.C. 637(d). For every large contract, the prime contractor must have a subcontracting plan. This plan sets goals for the large contractor to award small businesses a substantial percentage of the contract's dollars, and this plan lays out the means for making that happen. Devon E. Hewett, Jonathan T. Williams, and Isaias (CY) Alba, IV, Small Business Contracting Programs—Part II, 10-13 Briefing Papers 1 (2010). The small business subcontracting goal is 35.9%. But that is the goal within whatever fraction of the contract is chosen by the contractor to be subcontracted: the goal becomes a low dollar figure, in absolute terms, when the contractor does not subcontract much. For defense contracts, the Defense Contract Management Agency does oversight of the implementing of the subcontracting plan; for civilian contracts, the Small Business Administration does that oversight.

The so-called Test Program was created temporarily, or at least with the expectation that for the time being it would be temporary, pursuant to statute in 1989. Section 834 of the National Defense Authorization Act for FY 1990 and 1991.¹ Today this Test Program includes up to a dozen or two of the largest defense contractors like Lockheed Martin and Northrop Grumman. At the time, the CSPTP was adopted under the guise of increasing subcontracting opportunities for small businesses. In reality, it

¹ Recent Developments in Contract Law -- 1989 in Review, at subhead "Comprehensive Small Business Subcontracting Plans."

created a loophole that has allowed many of the Pentagon's largest prime contractors to circumvent the law on small business subcontracting goals. "The program is overseen by the Office of Small Business Programs (OSBP) in the Office of the Secretary of Defense (OSD)." U.S. Small Business Office of Government Contracting, Subcontracting Assistance Program (2006), at 90.

The Test Program applies only to DOD contracts, and does not apply to civilian contracts, but this does not limit its significance as one might think. A study found that "DOD accounts for . . . 71 percent of the reported subcontracting dollars [in the Small Business Subcontracting Program], and the civilian agencies account for about . . . 29 percent."²² So the fact that the Test Program applies to DoD contracting still makes it potentially applicable to about three-quarters of the small business subcontracting.

Rather than bidders on prime contracts pledging specific means and goals for small business subcontracting, the Test Program let the prime contractors merely speak of generalized companywide notions of such subcontracting. The "DoD Test Program for the Negotiation of Comprehensive Subcontracting Plans . . . allows participating contractors to have one company-wide subcontracting plan for all defense contracts, rather than individual subcontracting plans for every contract over \$550,000." Subcontracting Assistance Program *supra*, at 90. In this way, the Test Program let the Defense Department radically dilute and weaken its requirements for subcontracting plans from the large defense contractors.

Extension

The ASBL has calculated that the Pentagon may have deprived small business of subcontracting on over \$2 trillion of contracting since the program was started in 1989.

²² GAO, Small Business Subcontracting Report Validation Can Be Improved, Dec. 13, 2001, at 1.

And unfortunately, the program was extended to 2027. This was in section 826 of the 2017 National Defense Authorization Act. This would bring the so-called “test,” an experimental program, to its 38th year, which has to be some kind of unfortunate record for a test program.

Reduced Reporting

To foster the participation of small businesses in subcontracting, the Federal Acquisition Regulation (FAR) specifies that contracts have subcontracting plans for large contracts. FAR 19.704. Subcontracting is an evaluation factor for competitive offers, so, contractors potentially have a potent incentive to have strong goals for small business and strong means for achieving those goals. For DoD contracts, during the life of the contract, DCMA receives reports on that particular contract about small business’s role, overseeing that the prime implements their subcontracting plan. Subcontracting Assistance Program, *supra*.

The Test Program or CSPTP frees the big defense contractor from doing individual small business subcontracting plans. "The test program allows these companies to have one company-wide or division-wide subcontracting plan for *all defense contracts*." Subcontracting Assistance Program, *supra*, at 18 (all italics in this memo are added.)

. That does not merely mean non-preparation of a document. The large defense contractor in the program does not need to commit to a goal of small business subcontracting in any of its particular defense contracts -- no goal at all. The large defense contractor in the program does not need to commit to the means to achieve small business subcontracting -- no means at all. It is like letting prisoners in a prison system,

seeking parole, no longer have to commit to and to show individual good behavior and worthiness, but just that the prison population as a whole will, in some broad, vague way, not be so bad -- even though many or even most of the individuals being paroled are not worthy.

In diluting and weakening the small business subcontracting, the CSPTP plays a large role, because of, first, its scale. Just looking at the percentage of DoD spending in awards to CSPTP prime contractors would be understating the program. Even that understates the program. DoD prime contracting has two other exceptions to requirements for meaningful subcontracting for small business. Spending overseas was not required to be subcontracted. And, commercial contracting had greatly watered-down subcontracting requirements. So the fraction of subcontracting subject to meaningful small business requirements but excused under the CSPTP—the fraction left over after putting aside these exclusions – was bigger than 1/6. The CSPTP, together with the exclusions, threatens to cut a huge piece out of the best hopes for defense small business subcontracting.

Usually, a defense contractor feels strong pressure, at least in theory, to build strong elements into their subcontracting plan for each contract. As noted, the typical procurement makes small business subcontracting an evaluation factor for award of each contract. All else being equal, a defense contractor has a competitive advantage from a strongly positive evaluation for their subcontracting plan for their bid on a solicitation, and, loses a competitive advantage from a less positive evaluation for their subcontracting plan.³

³ Devon E. Hewett, Jonathan T. Williams, and Isaias (CY) Alba, IV, Small Business Contracting Programs—Part II, 10-13 Briefing Papers 1 (2010).

Another way to look at it: Contracting officials will suggest potent means for small business contracting. Here is a description of the potent means that officials will suggest for a subcontracting plan geared to a particular contract for a normal contractor (not CSPTP):

Conducting market research to identify small business subcontractors; breaking out contract work items into economically feasible units to encourage small business participation; soliciting small business concerns early in the acquisition process; providing interested small businesses with timely information regarding subcontracting opportunities; directing small businesses to contacts at the SBA that can provide additional assistance and utilizing the services provided by small business organizations associations, and local, state and federal assistance offices.

See Briefing Papers, *supra*.

For example, a contractor outside the Test Program will seek a high evaluation factor in competition for a particular subcontract by saying how it would beef up subcontracting for the particular contract. This means specifics, like tapping some specific pool of subcontractors geographically or functionally related to the particular contract. In contrast, a contractor inside the Test Program just offers broad overall generalizations. It does not have to propose high goals for a particular contract nor, to devise strong focused means to subcontract to small business for a particular contract; nor, to win favorable evaluation of such strong focused ways; and, it does not have to implement such strong focused ways. All it signs onto are broad, vague companywide generalizations.

To approach this by another, concrete illustration, a large contractor may compete for an IT prime contract – a contract that potentially could have valuable opportunities to give small business subcontractors a way to improve their ability to do quality IT subcontracting and, eventually, quality IT prime contracting (on a small scale) too.

Without the CSPTP, the large contractor would plan for focused ways to afford these small businesses those attractive opportunities, in order to secure evaluation points for seeking award of that prime contract. But, with the CSPTP, the large contractor would instead find it easier to do small business subcontracting in a less valuable way, like giving minor subcontracts for protective or janitorial services on a few of its less important contracts. This would look pretty much the same in companywide figures. And the large contractor could give the valued IT work to other large firms which return the favor.

There are some nuanced ways the CSPTP acts to undermine the effort at subcontracting to small business. Prime contracts ordinarily have a key reporting requirement that implements their commitments to subcontract to small business. This is the “Individual Subcontract Report” (ISR)(formerly SF 294). “The ISR is not required if the company is participating in the Department of Defense Test Program for Negotiation of Comprehensive Subcontracting Plans.” From “Fact Sheet, October 2010, Subcontracting Assistance Program,” on the web at SBLO Handbook: 06/15/2010. The CSPTP “waives the requirement for the semi-annual *Subcontracting Report for Individual Contracts*.” Subcontracting Assistance Program, *supra*, at 90

DoD cannot and does not do meaningful oversight of the contractor without that report on individual contracts. Giving up the key ISR reporting dilutes and undermines small business subcontracting. It is like giving up tax withholding from individual paychecks and watch as tax collections drop, or giving up collection of data from individual power plants and watching as pollution goes up. The ISR is the heart of the oversight of small business subcontracting. No ISR means much less subcontracting.

Initially, the Test Program started out with liquidated damages for contractors that fell short. In effect, the contract award had a built-in subsidy for fostering small business subcontracting; if the prime contractor failed to do that fostering, it repaid the government via the liquidated damages. But, contractors succeeded in killing the liquidated damages provision. That further weakened small business subcontracting in the Test Program.

Small businesses play a key role in our economy's job-creating and middle class aspects, and small business opportunities for government contracting dollars help small business in that key role. The CSTP has caused significant harm to small businesses playing that key role in the economy.

Next developments in the ASBL Case

In a previous round of this case, in November 2014, the trial judge, Judge William Alsup, accused the Pentagon and Sikorsky of trying to “suppress the evidence.” He instructed the Pentagon and Sikorsky on two separate occasions to “highlight the parts that are supposedly confidential” or that they believed were proprietary and to explain why they believed the information should be exempt.

When Judge Alsup ruled for ASBL, the Ninth Circuit reversed. But, it did not end or even stall the case, but sending it back to Judge Alsup for discovery and trial. Judge Alsup’s order allowing ASBL to depose Sikorsky and Pentagon witnesses in the case indicates that the case is going forward vigorously. So it may be that the mask of the program will finally be removed.