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**OPINIONS ON: (1) LARGE BUSINESSES WRONGFULLY HOLD  
SBA CONTRACTS BOTH BY ACQUIRING SMALL  
CONTRACTORS (2)AND, BY CONTRACTING WITH FORMERLY  
SMALL BUSINESSES AFTER THEIR GRADUATION;  
AND, (3) THE SBA WRONGFULLY REDUCES THE SCOPE OF  
CONTRACTING COUNTED IN APPLYING THE 23% SMALL  
BUSINESS GOAL**

Thank you for the opportunity to express my opinion on subjects involving the failure of the Small Business Administration (SBA) to provide an adequate level of federal contracts to small businesses, instead letting them go to larger contractors. I am Professor of Government Contracts at the University of Baltimore Law School and the co-author of *GOVERNMENT CONTRACT LAW IN THE TWENTY-FIRST CENTURY* (Carolina Academic Press 2012). I was Commissioner in 2008-2011 on the Congressionally chartered, independent Commission on Wartime Contracting in Iraq and Afghanistan. My opinion is my own and not an opinion of my school or any other entity.

To summarize: (1) large contractors cannot rightly acquire small businesses and retain the contracts; (2) small businesses, as they become large, should be "early graduated" out of small business status rather than allowed, to obtain and to retain small

business contracts; and (3) vast sums of Federal payments to businesses should be, but are not, counted when figuring the 23% goal for small business.

(1) and (2). Large contractors wrongfully hold "small business" contracts  
-- either by acquisition or by graduation

The press and other observers have noted that an extraordinarily high level of contracts ostensibly awarded to small contractors turn out to be going to large contractors. This is evident from looking at the government's FPDS database of contract awards and seeing the many contracts ostensibly going to small business that are actually being performed by Silicon Valley giants or other large contractors. The SBA does not deny that this occurs -- it would have to deny reality -- but gives out two excuses, each to be addressed here in turn. One excuse is that the large companies bought up small companies and now validly perform what had begun as small business contracts. The other excuse is that the companies receiving the awards started out as small businesses, but have grown larger and now continue to obtain orders and to perform what they were initially awarded as small businesses.

Both these excuses raise serious concerns. As the SBA Inspector General, Peggy Gustafson, testified, "The bottom line is that there is a real societal cost when ineligible companies improperly profit from preferential contracting through fraud and illegal conduct. . . . This fraud thwarts congressional intent behind these programs and deprives legitimate small businesses of contracting opportunities."<sup>1</sup>

As a leading commentary discusses: *Recertification*

Until 2007, a concern that certified itself as small and received an award of any set-aside contract was considered "small" for the full contract term, even if it grew to be other than small during the term of the contract. With the Government's increased

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<sup>1</sup> Charles Clark, *SBA Called Slow to Kill Duplicative Programs and Curb Improper Payments*, Gov't Exec., June 16, 2011.

reliance on multiple award contracts to procure goods and services, however, this rule led to "unsatisfactory results." Because these types of contracts had a term greater than 5 years, and often as long as 10 or 20 years, small business concerns were allowed to retain their size status and compete for orders issued under the contracts long after they outgrew the applicable size standard. . . . As a result, the Government found that a significant percentage of the orders issued under these long-term contracts were actually being performed by large businesses.

In 2006, the SBA amended its size certification regulations to address these findings. The SBA explained that the changes were necessary "to ensure that small business size status is accurately represented and reported over the life of these long-term Federal contracts."

Under the current certification regulations, a small business must recertify its status as small within 30 days after execution of a novation agreement or within 30 days following a merger or acquisition involving the business.

If the small business holds a "long-term contract," in addition to the recertification obligations associated with a novation, merger, or acquisition, a concern must recertify its small business status within 60 to 120 days prior to the end of the fifth year of the contract and within 60 to 120 days prior to the date specified in the contract for exercising any option thereafter.

Devon E. Hewitt, Jonathan T. Williams, and Isaias (Cy) Alba, IV, *Small Business*

*Contracting Programs--Part I*, 10-11 BRPAPERS 1 (2010)(text of footnotes can be found in the original).

As set forth in 13 C.F.R. sec. 121.404:

(1) Within 30 days of an approved contract novation, a contractor must recertify its **small business** size status to the procuring agency, or inform the procuring agency that it is other than small. If the contractor is other than small, the agency can no longer count the options or orders issued pursuant to the contract, from that point forward, towards its small business goals.

(2) In the case of a merger or acquisition, where contract **novation** is not required, the contractor must, within 30 days of the transaction becoming final, recertify its small business size status to the procuring agency, or inform the procuring agency that it is other than small. If the contractor is other than small, the agency can no longer count the options or orders issued pursuant to the contract, from that point forward, towards its small business goals. The agency and the contractor must immediately revise all applicable Federal contract databases to reflect the new size status.

Thus, suppose a small business named "Start-Up" landed a federal contract intended for a small business. After a year, Microsoft acquires "Start-Up." As soon as the small business executes an agreement -- a novation agreement that the contract will now be performed by Microsoft -- Microsoft is supposed to recertify that the contract-awardee's status is, and continues to be, small. Of course Microsoft would not be able, truthfully, to make that recertification, and so, when it is obliged to make the certification, it will instead give up, and not retain, the contract.

The rules that a contractor is "graduated" from the program in this way are also well known. As a leading commentator stated:

Provided that it maintains its eligibility, an 8(a) firm may remain in the 8(a) program for up to nine years from the date of the SBA letter certifying its admission to the 8(a) program. Once an 8(a) firm has "graduated" from the 8(a) program, it cannot reapply to the 8(a) program, even if it changes its name or comes under new management. Similarly, the disadvantaged individual upon whom eligibility was based may not use his or her disadvantaged status to apply to the 8(a) program with another company.

Devon E. Hewitt, Jonathan T. Williams, and Isaias (Cy) Alba, IV, *Small Business Contracting Programs -- Part II*, BRPAPERS (2010).

In fact, a 2011 SBA rules change tightened these rules up. The new rule "authorizes SBA to graduate a firm exceeding the size standard for its primary North American Industry Classification System (NAICS) code for three successive program years." *SBA Overhauls 8(a) Program*, Gov't Contractor Feb. 23, 2011. In other words, the SBA does not have to wait out the life of a long contract before graduating a small business. 13 C.F.R. sec. 124.302 states:

) where SBA determines that:

- (1) The concern has successfully completed the 8(a) BD program by substantially achieving the targets, objectives, and goals set forth in its business plan, and has demonstrated the ability to compete in the marketplace without assistance under the 8(a) BD program; or
- (2) One or more of the disadvantaged owners upon whom the Participant's eligibility is based are no longer economically disadvantaged.

A contracting officer may terminate for convenience a contractor which has had such an early graduation from the program.<sup>2</sup>

Thus, the problem is that SBA and the contracting agency are failing in their duties to police the arrangements made by small businesses with large businesses and/or after graduation. SBA and the agency are failing to demand recertifications, and failing to take action in the absence of valid certifications of continuing small size.

A GAO report in 2010 hammers home the point that large companies are not eligible to retain the small business contracts awarded to acquired small businesses. The report was entitled *8(a) Program: Fourteen Ineligible Firms Received \$325 Million in Sole-Source and Set-Aside Contracts*, GAO-10-425 (March 2010). In breaking down its findings, “numerous instances were found where 8(a) firm presidents made false statements, such as underreporting income or assets, to either qualify for the program *or to retain certification.*” *Id.* (Italics added.)

Going back further, another survey, like Bloomberg’s, surfaced many large firms receiving the benefits of small business programs.<sup>3</sup> A key survey, of the top 1,000

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<sup>2</sup> There is a provision that the contract remains with the small business for the contract's term. However, this is not specific to early graduation, and would not prevent the government from exercising its very broad discretion to terminate for convenience.



contractors receiving small business awards, was conducted for the SBA's Office of Advocacy in 2004.<sup>4</sup> It found 44 large companies, receiving \$2 billion in small business contracts, by some computer file cross-matching that basically comes down to looking up the company names. That SBA survey listed, as receiving extensive small business contracts, large companies including Titan, Raytheon, BAE, Northrop Grumman, CACI, L-3 Communications, the Carlyle Group, General Dynamics, EDS and SAIC.<sup>5</sup>

Large businesses are adept at making arrangements that obfuscate the situation. Large businesses may own what seem merely minority shares in small businesses, or otherwise may closely team with them coupled other relationships tying them together, or the small business may have multiple entities that purport to separate the one with the contract from the one with the large business tie but are in fact connected entities, and so on. The SBA's lack of policing gives the small firm a way to front for a large business without having to certify the contrary

Several reporters, Danielle Ivory and others at Bloomberg News, completed in February 2012 a study on this phenomenon. They published their results in several stories, and they invited this professor to review their data and comment on it in a televised Bloomberg News video.<sup>6</sup> This team of reporters had used public data mining

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<sup>3</sup> A study in 2004, which quoted this professor, found that "the small business contracts won by the largest defense firms amounted to \$9.3 billion." Elizabeth Brown, *The Big Business of Small Business: Top Defense Contracting Companies reap the Benefits Meant for Small Businesses*, (2004), at <http://www.publicintegrity.org/2004/09/29/6626/big-business-small-business>.

It discussed the role in this of inadequate policing by DoD of acquisitions by large companies of small contractors. "If it is truly a buy -- we should novate the contract, which would change the name, which would change the status. That is what should happen." *Id.*

<sup>4</sup> Eagle Eye Publishers, Inc., *Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002* (Dec. 2004), available at [www.sba.gov/advo/research/rs246tot.pdf](http://www.sba.gov/advo/research/rs246tot.pdf).

<sup>5</sup> *Id.* at 9-10.

<sup>6</sup> The stories include Danielle Ivory, Elliot Blair Smith and Gopal Ratnam, *Lawmakers Demand Crackdown on U.S. Program Enriching Wealthy*, Bloomberg Businessweek, Feb. 22, 2012. The video was *SBA Can't Police Contract Program, Tiefer Says*, Video, Bloomberg News, Feb. 21, 2012. The video has this website:

techniques<sup>7</sup> to look for situations in which a small business, which should have had its time in the SBA program come to an end, continued to get the benefits of the program. They looked for the bluntest, most in-your-face scenario: a company had continued in business, and had even stayed at the same address, after it should no longer be in the program -- yet had continued to receive SBA program benefits. "Since 1990, the SBA has certified multiple companies at a single address more than 100 times." *U.S. Program Enriching Wealthy, supra*.

"Twelve repeat participants have received \$412 million in preferential contracts and more than \$1 billion in total government awards, Bloomberg found." *Id.* A particular instance studied by Bloomberg involved "A Florida family [that] grew rich on \$256 million in federal contracts since 1993, in part through a web of closely held companies that allowed members to remain 18 years in the nine-year program for the disadvantaged." *Id.*

When the SBA Inspector General, rather than outside reporters, investigates an SBA program, the scale of improper payments can be startling. At a 2011 Senate hearing, the SBA Inspector General told Senator Landrieu about SBA loan guarantees in which she had found that 27% of the payments were improper.<sup>8</sup> At another 2011 hearing,

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<sup>7</sup> What is striking about the problem found in this way is that Bloomberg News does not have, of course, grand jury or subpoena power, and has neither government auditors nor government investigators. Bloomberg News found its information from data mining the contracting information on the public domain.

<sup>8</sup> Charles S. Clark, *SBA Called Slow to Kill Duplicative Programs and Curb Improper Payments*, Gov't Exec., June 16, 2011; *An Examination of Small Business Administration Programs: Eliminating Inefficiencies, Duplications, Fraud and Abuse: Hearing of the Sen. Small Business and Entrepreneurship Comm.*, June 16, 2011.

this time in the House, the SBA Inspector General said that publicizing reviews of one program prompted contractors to “drop out in droves.”<sup>9</sup>

Another SBA-IG report in 2011 looked at whether the agency was adequately policing some of the techniques by which large companies obtain contracts awarded to small contractors. It found: “there are regulatory limits on subcontracting which serve as an important control to preclude small business set-aside contracts from becoming “pass-throughs” to large businesses. However, our audit found that the SBA review teams generally did not evaluate whether small businesses and 8(a) firms were performing the percentage of work that is required by these regulations.” SBA-IG Report 11-11 *-Effectiveness of the Small Business Administration's Surveillance Review Process*.<sup>10</sup>

(3) Vast sums of Federal payments to businesses should be, but are not, counted when figuring the 23% goal for small business

SBA sets a goal of 23% of prime contracts for what contracts should go to small business. The question is, “23% of what”? The answer is that the SBA excludes vast sums of federal payments to business from that goal. The publication in which this is

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<sup>9</sup> Charles S. Clark, *Fraud Continues in Small Business Preference Programs*, Gov’t Exec, Oct. 27, 2011.

<sup>10</sup> Sharon Bernstein, *Auditors Find SBA Vulnerable to Fraud*, L.A. Times, Aug. 10, 2010.

In 2010, the Government Accountability Office issued a report in which it had tested whether SBA sufficiently vetted applications for government contracts under the HUBZone program. GAO submitted applications for four fake companies, “including one from a company [with its address] at the Alamo and one at a city hall elsewhere in Texas.”

Although the government does not prosecute criminally more than the tiniest sliver of large companies siphoning off the small business programs, its prosecutions show just how far larger businesses will go to do this – how tempting it is. “The two Orlando men were delighted in 2002 when their small business . . . won a \$50 million contract to provide foreign-language instruction for the U.S. Special Operations Command [SOCom]. . . . But a federal indictment this week charges the men . . . , with then forming a second company to obtain a \$100 million contract with SOCom in 2007 and fraudulently concealing or minimizing their involvement in the business. The indictment said they did so because [their company] was now too big and would not otherwise have qualified for the contract. . . .” William R. Levesque, 2 *Accused of Lying to Get \$100M SOCom Contract*, St Petersburg Times, June 23, 2011.



discussed is the "Small Business Goaling Report,"

[http://www.fedmine.us/fedconnect\\_bizopps/content.php?id=175](http://www.fedmine.us/fedconnect_bizopps/content.php?id=175).

Some individual exclusions seem quite arbitrary. SBA excludes the "Central Intelligence Agency," which suggests it probably also excludes the NSA. Perhaps the argument is that no one outside these agencies should be able to look at the scale of the agencies' small businesses. However, there is no reason that the contracting officer hierarchy in the CIA and NSA could not calculate the contracting totals, and look at the specifics for what contracts go to small contractors to see if 23% goals are met. Even if the CIA and NSA kept the goals, and how close they came to the goals, to themselves and did not forward them to the SBA (but provided the figures to the Congressional intelligence committees for oversight), it would be a step forward. Especially since 9/11, there have been huge amounts of contracts handed out, and small businesses should get a fair share. "A 2008 study, published by the Office of the Director of National Intelligence, found that contractors made up 29 percent of the workforce in the intelligence agencies but cost the equivalent of 49 percent of their personnel budgets." See Dana Priest & William M. Arkin, *Top Secret America; The Rise of the New American Security State* 181 (2011),

The Postal Service and TRICARE are listed by SBA as an exclusion. The Postal Service is subsidized by the taxpayer and should do its part for small business contracting. TRICARE is the operation within the Defense Department that pays for billions of dollars in medical care for DoD families. There is no reason to exclude any of TRICARE payments for which there are contracting officers.<sup>11</sup>

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<sup>11</sup> The exclusion says "Tricare DODAAC - H94002, HT9042 (based on Contracting Officer Code). " DODAAC means DoD Activity Address Code. It could not be determined what the address codes mean.

On a larger scale, there are many agencies which do not report, and yet should be part of the small business contracting effort. Many are lumped by the SBA Goaling Report under the heading: "Financial assistance actions e.g., cooperative agreements subsidies, and contributions . . . ." These include massive contracting actions, like highway construction, which are part of joint federal-state efforts. Another example is federal agricultural subsidies, which may be unduly to large agricultural businesses and not to the small farmers.

It may also be that subcontractors should be included in the count. Already, federal contractors shall have subcontracting plans. Subcontracting is relatively easier to award to small businesses than prime contracting, as subcontracting activities tend to be smaller and simpler. Yet, without a spur, many agencies may let subcontracts go excessively to large subcontractors.

Finally, there is an especially large realm of payments of federal funds to businesses that should be included. These are reimbursements for funding to health providers pursuant to Medicare, Medicaid, and VA healthcare. The payments go to businesses like others -- hospitals, nursing homes, durable medical equipment vendors, rehabilitation centers, and doctors' offices. Although these are not under the Federal Acquisition Regulation, yet they are actively regulated by the federal government. The agencies could condition the receipt by providers of their necessary authority to bill under these programs upon a set of requirements that would achieve small business goals. Doctors' offices and so forth would be encouraged to strive to succeed as small businesses, instead of the doctors just giving up and joinoing big companies for which the doctors are just rank-and-file employees.

The figure of \$1.1 trillion as the total amount that should be used for the 23% goal has been put forth in the media. Without breaking down the specific numbers, it should be evident that if all these categories currently excluded were included, the total funding for which to apply that 23% goal could reach that figure.