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## OPINION ON: PROPOSED CHANGE IN NONMANUFACTURER RULE

The SBA would make a serious mistake in changing the nonmanufacturer rule. The change would strike an unwarranted blow at the information technology (IT) "Solutions" industry. The IT Solutions industry is a vitally needed group of providers of combined services, software and hardware. It can be crushed by the giant IT firms with their enormous resources, for what makes that vital set of modest-sized providers viable is, in part, SBA set-asides. Changing the nonmanufacter rule will throw many of the modest IT Solutions firms out of those set-asides, and lead the government to move its IT Solutions contracting out of set-asides to a status where the giant IT firms will take over. The extended comment period for the new proposed SBA rule is at:

https://www.federalregister.gov/articles/2015/03/09/2015-05316/small-business-government-contracting-and-national-defense-authorization-act-of-2013-amendments

This opinion grows out of my previous opinion about the SBA sub-industry category for

IT-VARs. I incorporate that opinion by reference, here. That opinion showed the SBA should not try to define the modest size IT-VARs as not small businesses. Doing that, as the opinion showed, violates Congress's statutory intent in the Small Business Jobs Act of 2010, and, without justification, repeals the SBA's 2003 action recognizing this sub-industry. It struck a wholly unjustified hard blow at these struggling valuable modest sized businesses. On the proposed rule change addressed here, the SBA is again wrong in trying to do this -- and is wrong once again.

Let me explain. Normally, IT companies that are smaller than their industries size standards, like all government contractors smaller than their size standards -- even though they are larger than contractors in other industries -- qualify to compete for SBA set-asides.

However, they cannot bid for such set-asides if they use 50% or more of supplies from large contractors. As one of the leading commentaries on the rule explains, quoting SBA statements, "The purpose of the nonmanufacturer rule is to 'prevent brokerage-type arrangements whereby small 'front' organizations are set up to bid [on] government contracts, but furnish the supplies of a large concern." Deon E. Hewitt et al., *Small Business Contracting Programs -- Part I*, 10-11 Briefing Papers (2010).

Obviously the IT Solutions industry is not a "brokerage-type arrangement." The contracts are to obtain, and the IT Solutions provide, not just brokered items, but a combined mix of the services, software, and hardware to handle the broad aspects of government offices 'IT needs. It provides a mix, not just brokerage. The agencies are not looking for just items. They want to give their whole combined IT problem to a firm that can take on the whole mixture.

But now that would change. As the SBA explains, "The current method for determining whether a firm is in compliance . . . [is] to evaluate the percentage of the cost of the contract performance incurred for the prime contractor's personnel." But, the change "is to create a limit on the percentage of the award amount . . . set at 50% of the award amount received by the prime contractor."

The shift is part of what deals the blow to small businesses

Also, that change is across all categories of small businesses. There is an adverse change as to IT-VARs in particular,. The SBA says the proposed new section 121.1203(d) would work this way: "SBVA is proposing to address whether the nonmanufacturer rule should apply to certain software that can readily be treated as an item and not a service. SBA is proposing to treat this type of software *as an item and not a service*."

So if an IT Solutions firm would perform a contract with a mix of 45% supplied manufactured hardware items, 30% software, and 25% services, it appears that under this regulation it would be barred because of these changes.

. Quite a lot of IT Solution providers, and their bids, necessarily fall afoul of the SBA rule. And that is wrong. These IT-VARs are not brokers for Dell. They are not treating the Microsoft or Apple software that they install and service, just as brokered items. Government agencies seeking IT help often specify that the hardware must come Original Equipment Manufacturers (OEM), which are of course giant makers. Among other reasons, government

agencies often insist on uniform agency-wide IT systems, so the IT Solutions provider has no choice but to use OEM items. So all providers of solutions must provide those items -- they have no choice, and, their use of those items does not make them brokers.

The SBA touts that it can provide waivers. That is often an empty promise. It is always an inferior approach than simply writing the rule to treat the industry right. And it is possible that the SBA would have to grant very large numbers -- impractically large numbers -- of waivers to deal with this problem.

This rule change will mean thousands of small business concerns would be ineligible for government contracts. And, government agencies which see the shrunken pool of eligible contractors no longer meets their needs, would no longer set aside large numbers of the contracts most appropriate to be set aside.