

JOHN F. KERRY, MASSACHUSETTS, CHAIRMAN
CHRISTOPHER S. BOND, MISSOURI, RANKING MEMBER

CARL LEVIN, MICHIGAN
TOM HARKIN, IOWA
JOSEPH I. LIBERMAN, CONNECTICUT
PAUL D. WELLSTONE, MINNESOTA
MAX CLELLAND, GEORGIA
MARY LANDRIEU, LOUISIANA
JOHN EDWARDS, NORTH CAROLINA
MARIA CANTWELL, WASHINGTON
JEAN CARNAHAN, MISSOURI

CONRAD BURNS, MONTANA
ROBERT F. BENNETT, UTAH
OLYMPIA J. SNOWE, MAINE
MICHAEL ENZI, WYOMING
PETER G. FITZGERALD, ILLINOIS
MIKE CRAPO, IDAHO
GEORGE ALLEN, VIRGINIA
JOHN ENSIGN, NEVADA

PATRICIA R. FOPBES, MAJORITY STAFF DIRECTOR AND CHIEF COUNSEL
EMILIA DISANTO, REPUBLICAN STAFF DIRECTOR

United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

WASHINGTON, DC 20510-6350

April 8, 2002

BY FACSIMILE (202) 205-
ORIGINAL BY U.S. MAIL

The Honorable Hector Barreto
Administrator, Small Business Administration
409 Third Street SW
Washington, DC 20416

Dear Administrator Barreto:

As the author of the original HUBZone Act of 1997, and as author of a package of changes included in the Small Business Reauthorization Act of 2000, I welcome the opportunity to submit more comprehensive comments on the proposed rules published in the January 28, 2002 *Federal Register* (67 Federal Register 3826-44). Both of these legislative packages passed during my tenure as Chairman of the Senate Committee on Small Business (Committee), so I am particularly interested in rulemakings involving the HUBZone Program.

On January 29, 2002, I submitted a brief letter thanking you for carrying out the Committee's legislative intent in establishing parity between the HUBZone and 8(a) programs. My position on parity is well-known. It is vitally important that the Small Business Administration (SBA) carry out the Congressional intent behind legislation like the HUBZone Act; otherwise, negotiation and compromise become impossible. A deal, once struck, needs to be carried out. Parity was such a deal that made passage of the HUBZone Act possible. The previous SBA Administrator's effort to undermine that arrangement did incalculable damage to the bipartisan consensus that has normally prevailed in small business procurement programs.

Accordingly, these comments will continue to emphasize the need to implement the parity policy. However, the proposed rules cover significant additional topics, so I wish to amplify upon my January 29 letter to discuss those changes as well.

Generally. In addition to implementing the Congressional intent on parity, the proposed HUBZone rules make necessary changes to implement legislation adopted in the Small Business Reauthorization Act of 2000. The rules also clarify and simplify numerous provisions in the existing regulations, and strengthen the program's ability to deliver contracting dollars to our nation's most blighted pockets of poverty and unemployment. I do have concerns about proposed changes regarding the non-manufacturer rule and the regulatory definition of "employee," and these concerns are set forth below. With those exceptions, the rulemaking should proceed.

Non-manufacturer Rule (§§ 121.406, 126.601). Generally, the non-manufacturer rule requires that small business contractors must supply the end item of a small business manufacturer on Government contracts. This requirement encourages small businesses to start-up manufacturing operations to participate in the Federal procurement market. It also intends to strengthen the nation's defense industrial base by diversifying the number of vendors. Finally, the rule carries out the Government's general preference to do business directly with manufacturers and to eliminate middle-handlers that tend to increase the costs passed onto the taxpayers. The rule against non-manufacturers may be waived under certain circumstances.

SBA proposes to loosen the non-manufacturer rule to allow small business contractors to supply the end item of a large business manufacturer, in contracts below the \$100,000 simplified acquisition threshold. This policy would apply to contracts awarded through the HUBZone Program as well as other small business programs. In effect, the proposal is a general waiver of the non-manufacturer rule for contracts under \$100,000. For contracts above the simplified acquisition threshold, however, SBA proposes to tighten its policy--the proposed rule would state that waivers are not available to such contracts awarded through the HUBZone Program.

On numerous occasions, I have heard allegations that waiving the non-manufacturer rule has become a primary means of diluting the impact small business programs have in fostering growth and opportunity in the small business sector. I am particularly concerned that waivers tend to allow contracting dollars to flow "out the back door" to large firms, thus allowing large firms to benefit from programs intended to help small business. Worse, the dollars that actually flow to large firms may still be reported as achievements of the small business programs, simply because the prime contractor is small--even though the prime contractor merely passes the work and the benefits through to a large subcontractor. The non-manufacturer rule may have become a means to inflate the apparent successes of small business programs, without generating real benefit.

Accordingly, I have commissioned a study from the General Accounting Office, to try to separate fact from fiction on this issue. SBA's publication of these rules is premature and should await those findings. Otherwise, I am greatly concerned that SBA will replicate the problems of the existing non-manufacturer rule into the other programs it proposes to cover with this new rulemaking. This is a matter that needs careful study and direction from the Legislative Branch, preferably through legislation, prior to agency rulemaking.

In the case of the HUBZone Program, I have previously supported a much smaller waiver for contracts below the \$25,000 threshold. Contracts below that threshold are not significant enough to entice manufacturers to move into HUBZone areas, due to the costs of setting up such an operation. However, waiving the rule below that \$25,000 threshold would allow Federal agencies to buy from retailers in HUBZone areas, and contracts below that threshold could be

significant help to such firms. I therefore supported that change, but noted at the time I would be greatly concerned if the threshold were pushed much higher. SBA now proposes to do exactly that, and I do not support this change. It is premature and the need for it has not been shown.

For similar reasons, I support the express language of § 126.601(e)(1), stating that other types of waivers of the non-manufacturer rule would not be available in the HUBZone Program. The HUBZone Program is intended to foster economic growth and job creation in specific geographic areas, and frequent waivers of the non-manufacturer rule would remove the program's incentives for manufacturers to start operations in distressed areas. Allowing large firms in well-to-do areas to operate HUBZone fronts to take advantage of the program is contrary to the goals of the legislation.

Prime Contractor Performance Requirements and Subcontracting Limitations (§§ 125.6, 126.700). The HUBZone Act of 1997 places limitations on the amount of a HUBZone contract that may be subcontracted to other firms. Generally, 50% of the contract costs must be expended by one or more HUBZone firms, although the SBA Administrator may modify that requirement when appropriate to reflect conventional practices in a given industry. This is intended to ensure that HUBZone Program benefits flow to firms in the nation's most distressed areas, not to subcontractors located elsewhere.

These requirements are currently embodied in § 126.700 of the HUBZone regulations. SBA proposes to move these provisions to § 125.6(b), so that all small business subcontracting restrictions appear in the same place in its regulations, to reduce possible confusion. The new rules would also include changes adopted in the Small Business Reauthorization Act of 2000, prohibiting any subcontracting in connection with purchases of agricultural commodities, if the subcontractor would supply the commodities in substantially the final form that is to be supplied to the Government. Finally, the proposed rules would provide a formal, on-the-record process for adjusting the subcontracting limitations, with opportunities for public notice and comment. I support these changes.

SBA also expressly seeks comment on a proposal to require 50% of construction contract costs to flow to HUBZone firms. To reflect industry practices, the current HUBZone regulations allow general contractors to perform only 15% of the work and subcontract out the rest; specialty contractors must perform only 25%. This is typical of that particular industry and is also parallel to existing contracting requirements in other small business programs (see existing regulations at § 125.6(a)(3) and (4)).

Under the proposal, a general contractor would still need only perform 15% of the work, but would have to subcontract at least an additional 35% to other HUBZone firms, to make a total of 50% being performed by a HUBZone concerns. A comparable provision would be made for specialty contractors. These provisions would lessen the temptation for construction firms to

abuse the HUBZone Program, and would be consistent with the overall HUBZone Act goal that 50% of contract costs be expended in HUBZones. I support the proposed change.

HUBZone Program Definitions (§126.103). SBA proposes to make several changes to definitions of terms used in the HUBZone regulations.

--*AA/HUB.* SBA proposes to change the definition of the acronym "AA/HUB" to refer to the Associate Administrator for the HUBZone Empowerment Contracting Program. Currently, the term refers simply to the Associate Administrator for the HUBZone Program. I oppose this change.

The HUBZone Act of 1997 creates a program known simply as the "HUBZone Program." Nowhere in the statute is it referred to as the "HUBZone Empowerment Contracting Program." The reference to "Empowerment Contracting" was an effort by the previous Administration to take credit for a program it had no part in creating and which, in fact, it opposed in its Statement of Administration Policy issued September 8, 1997.

On May 21, 1996, President Clinton issued an Executive Order to launch an "Empowerment Contracting Program." Nothing in this Executive Order provided any authority for any of the provisions of the HUBZone Program. All authority for the HUBZone Program was contained in statute. The previous SBA Administrator nevertheless sought to claim some sort of relationship between the HUBZone Program and the "Empowerment Contracting Program," by claiming that the HUBZone rules should "build on" the President's Executive Order (63 Federal Register 16148, of April 2, 1998).

Contrary to the Administrator's claim, nothing in the legislative history says the HUBZone Program had any relationship at all to the "Empowerment Contracting Program." Nothing said the HUBZone Program should be implemented to "build on" President Clinton's Executive Order. In fact, neither the HUBZone Act nor any of the legislative reports makes any reference at all to the "Empowerment Contracting Program." SBA's continued reference to the program as the "HUBZone Empowerment Contracting Program" is potentially misleading, in that it may cause participants to look to President Clinton's Executive Order to understand the HUBZone Program requirements, all of which are contained in statute and not in the Executive Order. SBA should immediately stop any further references to the "HUBZone Empowerment Contracting Program," and should certainly not try to enshrine that misleading name in the regulations through this definition of "AA/HUB."

--*ANCSA.* SBA should consider adding a definition for the acronym "ANCSA" in its regulations. The proposed rules explain the acronym as referring to the Alaska Native Claims Settlement Act, under the proposed definition of "Alaska Native Corporation (ANC)." However, the acronym is used in other places in the regulations, without being spelled out (e.g., in the definition of "HUBZone SBC" and in § 126.200(b)(1)(ii)). This is potentially confusing. A

general definition of “ANCSA” would eliminate that confusion. Because the Alaska Native Claims Settlement Act has been amended significantly since it was originally passed in 1971 (most notably by a package of amendments in 1988), the term “ANCSA” should refer to the Alaska Native Claims Settlement Act, as amended.

--*Community Development Corporation (CDC)*. The proposed rules are potentially confusing in the definition of Community Development Corporation (CDC). The proposed changes are prompted by amendments to the HUBZone Act passed in the Small Business Reauthorization Act of 2000. The legislation defines a CDC as an entity “that has received financial assistance under part 1 of subchapter A of the Community Economic Development Act of 1981 (42 U.S.C. 9805 *et seq.*.)” SBA’s proposed rules shorten this to merely “42 U.S.C. 9805 *et seq.*” This open-ended reference could be construed as embracing more material than just part 1 of subchapter A. If SBA wishes to simplify the reference to contain only a U.S. Code citation, it should consider referring to Part A of Subchapter I of Chapter 105 of Title 42, as the statute was codified. Alternatively, the rule might refer to 42 U.S.C. 9805-08, but this might require a change if the Congress subsequently amended these provisions to insert new sections.

--*Employee*. The HUBZone Act of 1997 imposed a requirement on participating small firms, that they hire at least 35% of their employees from HUBZone areas. This provision is intended to ensure that the benefits of the program flow to the communities that need help. A substantial portion of the payroll of a HUBZone firm would need to “turn over” at least once in these distressed areas. Employees receiving that compensation would then need to buy groceries, gasoline, clothing, etc., so their incomes would help attract other small businesses into the distressed areas to fill those needs. The 35% requirement is a key factor in leveraging the HUBZone Program benefits to expand opportunity in distressed areas. It also establishes that a HUBZone firm does in fact have a strong nexus to the HUBZone community and is not simply a “front” seeking to draw on the program without fostering growth or creating jobs.

How SBA defines “employee” for this requirement is, therefore, a vital link in ensuring the program works as intended. Current SBA regulations generally define “employee” in terms of full-time equivalent (FTE) employees. This allows part-time employees to be counted but confers greater weight on full-time employees. The proposed rule would do away with the FTE calculation and would allow firms to count all as employees anyone working on a “full-time, part-time, temporary or other basis.” SBA claims this approach is simpler than current rules and would also increase job opportunities in the HUBZone areas.

Although I support efforts to ensure that all employees are counted in evaluating compliance with the 35% employment requirement, I am concerned that this approach may also weaken the nexus between participating firms and the HUBZone areas. If the 35% requirement is filled by temporary and transitory workers, the job creation goal of the program may be defeated.

The HUBZone Program provides key incentives to help firms win contracts if they are willing to provide jobs to HUBZone residents. To whom much is given, much is expected. If the HUBZone Program is to foster economic revitalization in distressed areas, the jobs created must offer employees the opportunity to learn skills and develop careers. Temporary jobs, created for the sole purpose of meeting the minimum possible HUBZone requirement, will prove an evanescent benefit and will not jumpstart HUBZone economies in the manner the program intends.

Further, abandoning the FTE approach will tend to draw SBA into a thicket. SBA intends to evaluate “the totality of circumstances” to determine whether part-time employees are bona fide employees under the regulation. Moreover, SBA states its intention (in the Section-by-Section Analysis rather than in the proposed rules themselves) that non-monetary compensation be acceptable. The only clear “bright line” in the proposed rule is that wholly uncompensated volunteers would not be considered employees. These proposed rules are an invitation to arbitrariness.

Worst of all, this new approach draws SBA into evaluating compensation levels (whether monetary or non-monetary) of HUBZone employees. This will inevitably lead to attempts to discover whether a compensation level amounts to “real” compensation or is merely a fig leaf to pass muster under the regulation, as SBA evaluates “the totality of circumstances.” Evaluating levels of compensation to make these judgments will draw SBA unduly into the day-to-day management decisions of HUBZone firms and will likely end in regulatory guidance on acceptable compensation levels to reduce the amount of arbitrariness in carrying out the proposed rules. This is a dangerous area for SBA and is outside the agency’s jurisdiction or competence. Minimum wage levels are set by the Congress and administered by the Department of Labor in accordance with statute. SBA should not get into the business of fixing minimally acceptable wages for participation in Government contracting by HUBZone firms, under the guise of determining whether compensation levels are “real” under “the totality of circumstances.”

The FTE approach is much more straightforward and involves fewer dangers down the road. It allows firms to allocate their workforces according to their needs, with a proper mix of full- and part-time employees. It provides a relatively objective measurement that will reduce arbitrariness. If SBA finds the current discussion on FTEs confusing, the agency should rewrite the provision to make it clearer. I do not believe SBA has shown the FTE approach to be unworkable, nor has the agency shown a need for the changes envisioned in the proposed rules. The FTE approach should be retained in the final rules, and safeguards should be included to prevent weakening of the HUBZone Program’s ability to generate jobs in distressed areas.

--*HUBZone SBC*. SBA proposes to change its definition of HUBZone small business concern (SBC) to reflect changes adopted in the Small Business Reauthorization Act of 2000. That legislation made HUBZone participation possible for certain small businesses previously

excluded due to the HUBZone Act's requirement that firms be 100% owned and controlled by U.S. citizens, which has been construed to bar ownership by corporate entities.

Generally, the proposed changes properly follow the legislative language, with one exception. The proposed rules would make Alaska Native Corporations, their direct and indirect subsidiaries, joint ventures, and partnerships eligible as HUBZone firms. The legislation is somewhat different: a small business that is an Alaska Native Corporation, and or an ANC-related entity, is eligible under the new statute. The proposed rule needs to be revised to follow the legislative language more precisely on this point.

Also, I am concerned about SBA's proposal to impose a 51% ownership requirement on partially-owned Indian Tribal enterprises. I will discuss this at greater length, below.

--*Indian reservation*. SBA also seeks to revise its definition of "Indian reservation" to reflect changes adopted in the Small Business Reauthorization Act of 2000. The proposed definition follows the statute well, but could be made clearer. The legislation wrote a specific rule for Oklahoma, due to that State's unique history. At one time, the entire State was a reservation, but all Oklahoma reservations were disestablished upon Statehood. I am concerned that SBA has buried the Oklahoma rule deep within subparagraph (2), where it might easily be overlooked. It may make more sense to break this provision out into its own subparagraph. Also, the Oklahoma proviso has a minor typographical error in it (an unnecessary dash after the word "that").

Eligibility Requirements for Certification (Definition of "HUBZone SBC" and § 126.200). SBA proposes to revise its rules describing the requirements for intended participants to be certified as qualified HUBZone small business concerns. The current rule requires a firm to be small, have a principal office in a HUBZone, hire 35% of its employees from HUBZones, and certify that it will comply with certain contract performance requirements. This provision must be updated to reflect changes adopted in the Small Business Reauthorization Act of 2000.

Generally, the proposed changes follow the new legislation, with two exceptions. The first of these is the proposed provision on small firms partially owned by one or more Indian Tribal governments. In conjunction with its revision to the definition of "HUBZone SBC," above, SBA is considering a limitation that such partially owned firms must be at least 51% owned by Tribal governments. SBA is concerned that partially owned Tribal enterprises might represent only a tiny ownership stake by the Tribal governments, thus creating a "front" that other owners could use to profiteer off the HUBZone Program. SBA expressly seeks comment on this point.

SBA is right to be concerned about the potential for such abuse, but in this case I believe SBA has failed to read the statutory changes in light of the entire policy that was adopted for

Tribal enterprises. Such Tribal enterprises actually face a much more stringent requirement than other firms with respect to contract performance. Other HUBZone firms must have a principal office in a HUBZone and must hire 35% of their employees from one or more HUBZones. This provision was replaced for Tribal enterprises with a much stricter standard: that 35% of the employees working on a HUBZone contract reside either on the reservation or in a HUBZone adjoining such reservation.

This contract-performance standard is stricter than the general HUBZone requirements in two ways. First, it applies to the specific contract awarded under the HUBZone program. Other HUBZone firms may hire HUBZone residents to perform work unrelated to a particular contract. Contracts awarded through the HUBZone program may not directly benefit HUBZone employees, other than to require that they work for the same firm in order to meet the 35% employment requirement. Those employees may in fact have nothing to do with performing the HUBZone contract. Tribal enterprises, however, would have to provide HUBZone residents with employment directly related to the contract performance.

Second, the pool of employees from which a Tribal enterprise must draw is much smaller than with other HUBZone firms. Other HUBZone small businesses may hire 35% of their employees from any HUBZone, including HUBZones in which the firm does not maintain its principal office. Tribal enterprises must hire from the pool of employees on the reservation or from a HUBZone adjoining the reservation--and, again, must provide them with work directly related to performing a HUBZone contract.

The Committee adopted this performance-based approach because of the unique role of Tribal enterprises. Most small businesses participating in the HUBZone Program will do so as privately-owned, profit-making enterprises. The HUBZone Program generally seeks to harness such private enterprises, motivated by the potential for profit, to reinvigorate the nation's most distressed areas. The Small Business Act, in fact, is primarily aimed at privately-owned, profit-making enterprises, and properly so. Longer range business interests will do more for economic development than short-range altruistic motives, which inevitably get frustrated at how difficult economic development really is in these distressed communities.

Tribal enterprises are a major exception to this rule. In many cases, Tribes are located on reservations in desolate wasteland. Ordinarily, small businesses will be even more reluctant to move to these reservations to set up shop. Because of this chronic lack of investment, Tribal governments have set up their own enterprises to invest in their own communities. Often these enterprises are the only source of investment on the reservation, and their resources are often quite limited.

The HUBZone Act, as amended, seeks to recognize the unique role of these Tribal government-sponsored enterprises. The Tribal government is seeking to provide jobs for the

members of its own Tribe. This is why the new provisions provide more stringent requirements, that employees come from the reservation governed by the Tribal owner or from adjoining HUBZones and that those employees must directly benefit from the contracts awarded to the enterprise.

In combination with these more stringent requirements, I am greatly concerned that the 51% Tribal government ownership requirement will become too much of an insurmountable burden. Tribal enterprises would have to meet contract-performance requirements that other HUBZone firms would not have to face, and furthermore would be unable to leverage their limited resources with non-government investors. I doubt the potential for abuse is as great as SBA fears, since I would think non-Tribal investors would rather set up their own HUBZone concerns and avail themselves of the program without facing the contract-performance requirements imposed on Tribal enterprises. I am concerned that these provisions will effectively prevent any real-world use of the opportunities offered under the new legislation.

A second area in which the proposed rules depart from the Small Business Reauthorization Act of 2000 is with respect to the generally applicable provisions that a firm “attempt to maintain” the relevant 35% employment requirement and that it comply with the limitations on subcontracting. SBA’s proposed rules place these two provisions within paragraph (b) of § 126.200, so that they would not apply to Tribal enterprises described in paragraph (a). This is not a correct reading of the statute. Tribal enterprises have a different employment requirement, in that they must have 35% HUBZone employees working on a HUBZone contract, but they must “attempt to maintain” that threshold. Further, they are not permitted to subcontract out all the program benefits any more than other HUBZone firms may do so. These “attempt to maintain” and subcontracting provisions appear in § 3(p)(5)(A)(i)(II) and (III) of the Small Business Act, and both of them apply to all HUBZone small business concerns described in subclause (I), whether Tribal enterprise or otherwise.

Participation in Other Small Business Programs (§ 126.205). The proposed rules would revise an existing section stating that women-owned firms, 8(a) participants, and Small Disadvantaged Businesses may participate in the HUBZone Program as long as they meet HUBZone Program requirements. The new rule would make this a more general statement by deleting the specific list of other SBA programs, thus saving the agency from having to re-write this section periodically. This change simplifies the rule without losing any content, and I support the change. As a further clarification, SBA should consider adding a statement that participation in other SBA programs is not a requirement for participation in the HUBZone Program.

Filing of HUBZone Application (§ 126.303). SBA proposes to revise its existing rule that says where applications for HUBZone certification should be filed. The current rule provides a physical mailing address for the HUBZone office, which disregards the ready availability of

filing over the Internet. The new rule would provide an address to which electronic applications should be submitted. However, the current wording of the proposed rule is confusing, in that it implies a firm must submit both an electronic and a paper application, which is not SBA's intention. ("A firm seeking certification. . . must submit its electronic application to [address] and its written application to [address].") The rule should be clarified so that firms know they need only submit one or the other, and not both.

Use of SBA Maps to Determine Location within Reservation Boundary (§ 126.304). SBA seeks to update its rule on documentation submitted to SBA as part of an application, to reflect the availability of electronic maps. Specifically, when SBA first began certifying HUBZone firms, it did not have electronically-formatted maps to show HUBZone locations within the external boundary of an Indian reservation. SBA now has that information, and wants to revise its rule to refer users to those maps. It would be helpful if this rule stated where those maps could be found (presumably the HUBZone website).

Continuing Obligation to Notify SBA of Material Changes (§§ 126.306, 126.501). SBA proposes to delete language in the current rule that a certification decision will be based on solely on the facts and supporting materials provided at the time a prospective firm applies for the HUBZone Program. Although it is reasonable for SBA to base a decision on the application materials it has received, SBA also has an obligation not to disregard "red flags" or other contradictory information that may come into its possession prior to certification. The rule rightly reserves SBA's authority to request additional information related to an application.

However, SBA should consider imposing an obligation on the firm to notify SBA of material changes that occur after submission of an application and before certification. Under § 126.501, a qualified HUBZone firm (one that has actually received its certification) has a continuing obligation to notify SBA of material changes that could affect its eligibility under the program. SBA should revise § 126.306 to make this obligation begin when the firm submits its application, not when it receives its certification. SBA can then reasonably rely on the application materials submitted, with the knowledge that the firm is obligated to notify the agency of material changes that render the application materials incomplete or inaccurate. Without this change, the period after application and before certification could become a loophole during which firms make material changes without being expressly required to notify SBA.

The revised § 126.501 lists several specific subjects on which HUBZone firms have a continuing obligation to notify SBA of material changes. SBA should consider a cross-reference to § 126.200 to direct firms to a more comprehensive list of HUBZone Program requirements that are covered by the "material change" obligation. For example, § 126.200 includes requirements that a participating firm be small under the relevant size standard; this is not listed in the proposed § 126.501.

List of Qualified HUBZone Small Business Concerns (§ 126.307). The HUBZone Act requires SBA to maintain a list of the firms it has certified for the HUBZone Program. SBA's proposed rules would clarify where users (such as agency contracting officers) may go to find this List, to reflect changes in SBA's HUBZone website address. The proposed rules also mention that the List can be found using SBA's PRO-Net database, which contains HUBZone firms and other small firms interested in Federal procurement. The proposed rule should be clarified to indicate that finding the List requires running a search of the PRO-Net database; otherwise, users may go to the PRO-Net site looking for a specific link to click upon to find the List.

Maintaining HUBZone Certification (§§ 126.500, 126.501). Current SBA rules require certified firms to renew their certification annually by informing SBA that they continue to be eligible. SBA proposes to change this from yearly to every three years. I support this change as an administrative convenience for both SBA and the HUBZone firms. The proposed rule should remind firms that they have a continuing obligation to notify SBA of any material changes in their eligibility, perhaps by cross-reference to § 126.501. Further, since this section of the rules addresses how a firm maintains its SBA certification, the question heading the section should be revised to read "How does a qualified HUBZone SBC maintain HUBZone certification?" The current question refers to HUBZone "status" instead of certification, which suggests broader issues of eligibility for the program rather than just certification. These "status" issues are addressed in the subsequent section, § 126.501.

In its Section-by-Section Analysis, SBA explains the extension from one year to three years by noting that the Small Business Reauthorization Act of 2000 provided for "redesignated areas" to continue participating in the HUBZone Program for three years. That is, once a HUBZone area has become otherwise-unqualified due to the release of new economic data, it becomes a "redesignated area" for a three year period, to allow firms in the area to finish their participation in the HUBZone Program. I do not agree with the analysis that suggests a connection between the three-year redesignated area provision and the three-year period for submitting renewal paperwork.

Unlike other small business programs, the HUBZone Program attaches eligibility to geographic areas and not to specific firms. Firms become qualified when they establish and maintain a sufficient nexus to the eligible geographic areas. If at any time the firm loses its nexus to the eligible HUBZone areas, it is no longer qualified to participate--hence the requirement that firms "attempt to maintain" a 35% HUBZone employment level and the continuing need to notify SBA of any material change that could affect the firm's certification.

Certified HUBZone firms need to understand that they do not have a blanket three-year period in which they may do whatever they want while participating in the HUBZone Program. Their certification does not extend for a fixed period of years, as is done with the nine-year

participation period for firms in the 8(a) program. The redesignated area provision was expressly designed to avoid attaching certification to firms for a fixed period of years, and instead extended eligibility to certain geographic areas.

SBA's Section-by-Section Analysis properly recognizes this difference in another place, in its discussion of the proposed definition for "redesignated area" in § 126.103. There, SBA notes that a firm moving into an already-reclassified "redesignated area" would have less than three years to participate in the program, since the clock would already be running on the three-year extension. See 67 Federal Register 3826, at 3829. I am concerned that SBA's discussion on this point in §§ 126.500 and 126.501 may tend to confuse applicants by suggesting a three-year period of eligibility, possibly leading to inadvertent rules violations by those firms.

Finally, I find an inconsistency between § 126.500 and § 126.501. The former section states that a decertified firm would need to submit a new application under § 126.309, while the latter section refers to a new application under §§ 126.300 through 126.306. SBA should consider making these references consistent.

Decertification Procedure (§ 126.503). The proposed rules would move language from the current § 126.404 into a more comprehensive discussion at a new § 126.503. This new section would discuss the manner in which a firm's certification is reviewed for possible revocation. The new language also makes some improvements over the existing language.

Currently, the decertification rules suggest a bias against the firm under review. Such a firm would receive a written notice from SBA "why it is no longer eligible" (§ 126.404(a)). This language suggests SBA has already decided against the firm. The new language would instead notify the firm that SBA is proposing to decertify it and that the firm is being asked to rebut certain issues. This is a much more impartial regulation that suggests the firm is more likely to get a fair opportunity to respond.

In most cases, the proposed rule states that the decertification decision will be made by the AA/HUB or designee. In (a), however, the proposed rule refers to the Deputy AA/HUB or designee. I recommend this section be made consistent throughout.

Attempt to Maintain 35% Employment Threshold (Definition of "Attempt to Maintain," §§ 126.200, 126.601(c)(4), 126.602). The HUBZone Act requires that participating firms attempt to maintain a threshold of 35% of employees from HUBZone areas. For Tribal enterprises, 35% of employees working on a HUBZone contract must be from the Tribe's reservation or from adjoining HUBZones. As discussed previously, I believe a strict reading of the Small Business Act will show the "attempt to maintain" standard applies to Tribal enterprises as well as other HUBZone firms. See *Eligibility Requirements for Certification*, above.

SBA proposes to create a definition of “attempt to maintain,” to make it more readily accessible. The term is currently buried within § 126.602. This is a reasonable approach, particularly since the term is used elsewhere in the HUBZone regulations. However, I am concerned the average reader will not realize that “attempt to maintain” is a specific term of art with a specific definition. Users of the regulations may not think to look in the definitions for an explanation of this term. It may be helpful to include a cross-reference to the definitions section (§ 126.103).

Marketing to Receive HUBZone Contracts (§ 126.603). SBA proposes to clarify its rule emphasizing the need for firms to market themselves to win HUBZone contracts. HUBZone certification does not guarantee award of HUBZone contracts; certified firms must aggressively pursue contracting officers who want to buy the goods or services the firms want to sell. Both the existing rule and the proposed rule include a confusing statement that marketing will “increase [the firms’] prospects of having a requirement set aside for HUBZone contract award.” The HUBZone Program provides benefits other than the opportunity to win contracts through competition restricted to HUBZone firms (a HUBZone set-aside). The rule should be broader to encompass HUBZone awards through other means (sole-sourcing, full-and-open competition). I suggest the rule refer to “prospects that the contracting activity will adopt an acquisition strategy that includes HUBZone contract opportunities.”

Excluded Contracts (§§ 126.605, 126.606). I support SBA’s proposal to permit purchases below the micropurchase threshold from HUBZone concerns. Current SBA regulations state that micropurchases (usually made with the Government purchase card) are not available as HUBZone contracts. Micropurchases generally are intended to be simple and straightforward, so it is understandable that the Federal Acquisition Regulation (FAR) states that “micropurchases do not require provisions or clauses” in the sense of formal contracts (FAR, § 13.201(d)). The absence of formal contracts may preclude more complex approaches to HUBZone contracting, such as full-and-open competition and its associated 10% price evaluation preference. However, this does not mean contracting officers should be precluded from purchasing from HUBZone firms. Indeed, the FAR states that “to the extent practicable, micropurchases shall be distributed equitably among qualified suppliers” (FAR, § 13.202(a)(1)). Barring all HUBZone firms, as a class, from micropurchases does not seem very equitable. SBA’s proposed rules would correct this policy.

This same provision also retains the basic existing policy, that contracts currently performed by an 8(a) program participant are unavailable for award as HUBZone contracts, unless SBA consents to release of the contract from the 8(a) program. This is further amplified in § 126.606, stating that SBA will release such a contract only when neither the incumbent 8(a) firm nor any other 8(a) firm is available to perform the new contract. This is such an eminently reasonable approach I am surprised anyone has grounds to criticize it. If no 8(a) firm is available to perform the contract, the only alternative to releasing it is to allow the contract to go unfilled

indefinitely. This would be poor policy and would prevent other agencies from carrying out their responsibilities.

Parity Between the HUBZone and 8(a) Programs (§ 126.607). When the Senate considered the HUBZone Act of 1997, the relationship between the HUBZone and 8(a) programs was a contentious issue. Advocates for the 8(a) program were concerned that HUBZone contracts would be awarded at the expense of the 8(a) program, and HUBZone advocates worried that few contracts would be available for the new program and it would never be given a real chance to succeed.

The Senate Committee on Small Business reached a compromise on this issue by vesting contracting officers with the discretion to decide which program to use in awarding a particular contract. This compromise was embodied in the legislation, by placing the responsibility on contracting officers (e.g., “Notwithstanding any other provision of law, a contracting officer may. . .” (Small Business Act, § 31(b)(2)(A))). This agreement was further amplified by report language filed by the Senate Committee on Small Business:

It should be noted that the HUBZone Program is not designed to compete with SBA’s 8(a) Program. One of the amendments adopted by the Committee during its markup of this legislation places a HUBZone small business concern at the same level of contracting preference as an 8(a) small business concern. The bill, as amended, gives the procuring agency’s contracting officer the flexibility to decide whether to target a specific procurement requirement for the HUBZone Program or the 8(a) Program. S. Rpt. 105-62, at 26.

With this compromise, the HUBZone Act passed the Congress and was signed by the President on December 2, 1997. When the language of this compromise was passed in the House of Representatives by voice vote on November 9, 1997, the compromise became binding on the House Members as well as the Senate and the President. Regrettably, some Members of the House no longer feel bound by the agreement to which they previously consented. This will tend to complicate our task to reach bipartisan consensus and to negotiate compromises in future legislation. Agreements, once struck, must be kept.

Some have cited a letter from former SBA Administrator Aida Alvarez as justification for undercutting the parity compromise. Administrator Alvarez wrote Representative John J. LaFalce that she would not permit “implementation of the HUBZones [sic] program to negatively affect the 8(a) program” (letter of November 8, 1997, inserted in the *Congressional Record* of November 9, 1997, at H10499). This goal is not contrary to the Senate Committee’s position. In fact, the parity compromise was precisely aimed at protecting both programs and giving both programs a chance to succeed.

The Senate Committee, with its compromise passed by the entire Congress, sought to protect the 8(a) program, but it sought to do so in a particular manner: parity. Nothing in former Administrator Alvarez' letter suggested that she would attempt to disregard the Congressional intent by elevating one program over the other in a fashion contrary to law. Accordingly, I was appalled when the previous Administration attempted to construe the old language of 13 C.F.R. § 126.607 to place an automatic and inflexible priority on the 8(a) program, in violation of the discretion vested in contracting officers by statute.

Now SBA is finally clarifying this language, removing the ambiguous phrases the previous Administrator used in attempting to breach the parity compromise. This rulemaking must go forward. Every second that passes with the unlawful former policy in effect is a breach of the HUBZone Act and a direct assault on the rule of law.

The new language is in fact a significant improvement. Without circumventing the discretion vested in the contracting officers, the regulation directs that they must consider how their contracting activity is doing in carrying out the relevant procurement goals. The contracting officer is not ordered to base his or her decision on the goals, but he or she must factor that into the determination. Moreover, the rule preserves the contracting officer's discretion by directing review of "other relevant factors."

This seems consistent with the entire purpose of having contracting goals. If contracting officers are not to consider their achievements in making contract decisions, what is the point of having goals at all? If the goals do not guide contracting officers in their day-to-day activities, they become a meaningless exercise.

This view is not undermined by the absence of a separate, statutory 8(a) goal. First, many agencies set internal targets for 8(a) participation. At such agencies, an 8(a) goal is in fact available for comparison to the agency's achievements through the HUBZone Program.

Second, agencies that might not set 8(a) goals are still guided by the overall Small Disadvantaged Business (SDB) goal. This goal (5% of prime contracting dollars) is actually higher than the ultimate HUBZone goal (3%). The 8(a) program provides an important piece to help the Government develop and graduate minority firms that will be able to continue in Federal procurement as SDBs. For goaling purposes, 8(a) firms are presumed to be SDBs. However, 8(a) is only one piece of the Government's efforts to enhance minority participation in contracting (for example, some contracts may offer a 10% price evaluation preference for SDB firms in full-and-open competition). The SDB goal makes a perfectly useful tool for contracting officers in comparing their minority participation rates with HUBZone participation rates.

The Congress has not previously wanted to negotiate the thicket of which minority firms should take priority over other minority firms. Should part of the SDB goal be carved out solely

for 8(a) firms, at the expense of 8(a) graduates and other non-8(a) firms? How much of the SDB goal should be walled off and unavailable to assist other non-8(a) minority firms? Pitting different groups of minority contractors against each other is a formula for unraveling the entire program. I am unwilling to head down that road.

The approach embodied in the new § 126.607 is a reasonable and workable one and should proceed. I do think the opening clause in paragraph (b) should be revised for clarity. Paragraph (a) states that contracting officers must first review a proposed HUBZone requirement to see if a mandatory source (such as Federal Prison Industries) must receive the contract instead, or if the contract is currently performed by an 8(a) participant. Then, paragraph (b) states that “after determining that paragraph (a) of this section does not apply,” the contracting officer should evaluate whether to consider the HUBZone or 8(a) programs. Paragraph (a) of this section always applies; contracting officers must review the contract to determine if it must be awarded to a mandatory source or retained in the 8(a) program. What may not apply are the exclusions referred to in paragraph (a), not paragraph (a) itself.

Review by Procurement Center Representatives (§ 126.610). The proposed rule clarifies and strengthens authority for SBA to challenge decisions not to award contracts to HUBZone concerns. This process would begin with SBA’s Procurement Center Representatives (PCRs), SBA’s expert staff responsible for reviewing agency acquisition strategies. Ultimately, the SBA Administrator would be able to appeal the decision directly to the head of the relevant agency. Making this authority clear is an important step forward.

Price Evaluation Preference (§ 126.613). SBA proposes a package of changes to clarify application of the 10% price evaluation preference in certain contexts, to reflect changes in contracting practices and amendments to statute.

--*Best Value Contracting.* SBA proposes new language to guide contracting officers as they apply the preference in best value contracting. Best value contracting may result in an award decision based on non-price factors, leading to an overall assessment of which offer represents the “best value” to the Government. This tends to limit the utility of the HUBZone preference, however. Under the proposed rule, the 10% price evaluation preference would be a factor in assigning evaluation points based on the price component of the best value analysis. This is a long-overdue clarification that preserves some value for the price evaluation preference without undermining legitimate needs for best value contracting.

--*Agricultural Commodities.* SBA also seeks to implement the restrictions on the price evaluation preference adopted in the Small Business Reauthorization Act of 2000, regarding purchases of agricultural commodities. The regulations appear to follow the legislation properly. I encourage SBA to work with Department of Agriculture contracting staff to ensure its regulations allow this analysis to be done electronically, as part of the automated evaluation of

bids that often involve millions of complex calculations.

Resolution of Contract Disputes and Protests (§§ 126.617, 126.801). The proposed rules would clarify that SBA does not resolve disputes over contract administration and related issues between the contracting agency and a HUBZone contractor. SBA also would not review protest issues arising in such disputes. This limits SBA to its proper role in carrying out the HUBZone Program, without interfering in contract administration issues that lie properly with the contracting agency, the General Accounting Office, or other agencies of jurisdiction. SBA's intention on these questions is clearly stated in the Section-by-Section Analysis, but a typographical error causes the proposed rules themselves to state the opposite. In § 126.801(a), the proposed rule states that "SBA does review protest issues concerning the conduct or administration of a HUBZone contract." The "not" was inadvertently omitted. This error needs to be corrected or SBA will end up with rules that state the opposite of what was intended.

Participation in Mentor-Protege Programs (§ 126.618). The proposed rules specify that HUBZone firms may participate in Mentor-Protege programs, as long as the Mentor-Protege agreement does not result in relationships that violate other HUBZone Program requirements. The mere existence of a Mentor-Protege relationship would not by itself be grounds for finding affiliation between the two firms that could cause the Protege to be deemed an ineligible non-small business. However, if the large Mentor firm would be performing "primary and vital requirements" of a contract, SBA may find an affiliation between the two firms that causes the Protege to be disqualified as a HUBZone firm. Moreover, a Mentor may not joint venture with a Protege unless the Mentor is also a HUBZone small business concern. These are important protections against misuse of the Mentor-Protege program to create "fronts" that allow large firms to benefit from small business programs.

Thank you for this opportunity to comment on this landmark rulemaking. I commend SBA's entire staff and especially its HUBZone staff for their hard work in implementing the changes directed by the Small Business Reauthorization Act of 2000, as well as their re-examination of SBA's policy on parity between the HUBZone and 8(a) programs. If you have questions about these comments, please contact Cordell Smith of my Senate Small Business Committee staff on (202)224- .

Sincerely,



Christopher S. Bond
Ranking Member

cc: Michael McHale
Associate Administrator,
HUBZone Program