



*Advocacy: the voice of small business in government*

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Via Facsimile and Electronic Mail

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General Services Administration  
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Electronic Address: [www.regulations.gov](http://www.regulations.gov)

**RE: FAR Case 2006-007, Contractor Code of Ethics and Business Conduct**

Dear Ms. Duarte:

The U.S. Small Business Administration's (SBA) Office of Advocacy (Advocacy) submits the following comments on the proposed rule to require contractors to implement a code of ethics. The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) *requested comments on the proposed Code of Ethics and Business Conduct regulation.*<sup>1</sup> Advocacy and small businesses welcome the efforts of the Councils to increase the level of corporate accountability. However, to achieve maximum benefit from this increased level of accountability, several areas of the proposed regulation require refinement. These refinements are set forth below.

Advocacy has been contacted by several small business organizations concerning the impact of the proposed rule on small business. In addition, as a result of public comments submitted prior to the original comment closing date from organizations representing a substantial number of small businesses, Advocacy strongly recommends that the Councils publish an initial regulatory flexibility analysis as required by Section 603 of the Regulatory Flexibility Act.<sup>2</sup> Advocacy would further urge the Councils to give careful consideration to the need for reasonable alternatives for small business

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<sup>1</sup> *Request for public comments*; 72 *Fed. Reg.* 32, 7588 (Feb. 16, 2007). Comment deadline extension, 72, *Fed. Reg.* 77, 20092 (April 23, 2007).

<sup>2</sup> 5 U.S.C. § 603.

compliance with the proposed regulation. Advocacy also urges the Councils to review the flow down provision of this proposed regulation to small business subcontractors. In view of the apparent lack of data on small business subcontractors, Advocacy recommends delaying the flow down requirement to these contractors.

### **Office of Advocacy**

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),<sup>3</sup> as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),<sup>4</sup> gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.<sup>5</sup> Moreover, on August 13, 2002, President Bush signed Executive Order 13272,<sup>6</sup> which requires federal agencies to notify Advocacy of any proposed rules that are expected to have a significant economic impact on a substantial number of small entities and to give every appropriate consideration to any comments on a proposed or final rule submitted by Advocacy. Further, the agency must include, in any explanation or discussion accompanying publication in the *Federal Register* of a final rule, the agency's response to any written comments submitted by Advocacy on the proposed rule.

### **Background**

The Federal Acquisition Regulations (FAR) Part 3 provides guidance on improper business practices and personal conflicts of interest but it does not provide guidance on a code of ethics or business practices. The Department of Defense, Department of Veterans Affairs and the Environmental Protection Agency, however, have long standing policies for contractor, large and small, codes of ethics and business conduct. In part because of a lack of federal government -wide guidance in this area, the Councils have proposed to provide policy for all agencies.

Section 3.1003 of the proposed regulation would make company compliance systems mandatory for federal contracts in excess of \$5 million with a performance period of 120 days or more. If the award meets these conditions, the contractor must establish a code of ethics and a training program for the company within 30 days of contract award. The two

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<sup>3</sup> 5 U.S.C. § 601 et seq.

<sup>4</sup> Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

<sup>5</sup> 5 U.S.C. § 603.

<sup>6</sup> See, Executive Order 13272, *Proper Consideration of Small Entities in Agency Rulemaking* (67 Fed. Reg. (53461) (August 16, 2002).

exceptions to this regulation are commercial item contracts under Part 12 of the FAR and contracts performed outside of the United States.

The requirements of Section 3.1003 would also flow to a subcontractor that is awarded a contract in excess of \$5 million.

## **Discussion**

Under the RFA federal regulations must generally undergo certain regulatory analyses and review before they are finalized. One of these analyses is an Initial Regulatory Flexibility Analysis (IRFA) required by Section 603 of the Regulatory Flexibility Act (RFA). An IRFA is required whenever a federal rule is expected to “have a significant economic impact on a substantial number of small entities.”<sup>7</sup> In this instance, the Councils did not prepare an IRFA because of the expectation that there would not be an economic impact on a substantial number of small entities.<sup>8</sup> As such, the Councils “certified” the rule in accordance with section 605(b) of the RFA. However, numerous small businesses will be required to comply with this mandatory rule, and the costs to them will be significant.

- A. Number of affected small entities. According to data from FPDS-NG, the government’s official procurement reporting system, there were approximately 763 small businesses in FY 2005 that received prime contract awards above the \$5 million threshold proposed for this rule. Also, there were nearly 356 single small business prime contract actions at a value in excess of \$5 million in FY 2005. While data is not available for FY 2006 it is reasonable to assume that these numbers will only increase as the size of the federal acquisition budget increases.
  
- B. Subcontracting. The proposed regulation would flow down the mandatory compliance program requirements to subcontractors. The above numbers do not reflect the small business subcontractors. While small business participation at the subcontracting level is more difficult to tabulate and the data that is available is a little less current, it is known that for the last year subcontracting dollars have been certified by the Small Business Administration (SBA)<sup>9</sup> that small businesses were awarded nearly 45 billion dollars. Some small businesses rely heavily on subcontracting opportunities to penetrate the federal marketplace and to pave the way for them to develop a track record that will lead to prime contracts. According to a General Accountability Office report to Senator Bond, “subcontracting is an important avenue for enabling small businesses to

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<sup>7</sup> See, Executive Order 12866, *Regulatory Planning and Review*, available at [http://www.whitehouse.gov/omb/infoereg/eo12866/eo12866\\_amended\\_01-2007.pdf](http://www.whitehouse.gov/omb/infoereg/eo12866/eo12866_amended_01-2007.pdf)

<sup>8</sup> 5 U.S.C § 603(a).

<sup>9</sup> [www.sba.gov/goals](http://www.sba.gov/goals)

participate in large dollar federal contracts.”<sup>10</sup> DOD accounts for about two-thirds of federal procurement dollars and has a critical role in providing opportunities to small businesses through subcontracting.<sup>11</sup> The proposed regulation has not estimated the number of small business subcontractors that will be adversely affected by this mandatory flow down requirement. In addition to the cost, this proposed regulation has not addressed the issue of how this flow down to subcontractors will be enforced.

- C. Economic impact. If a small business is required to implement an employee ethics and compliance training program and an internal control system, it is estimated by at least one established professional organization that the minimal set-up cost will be around \$10,000.<sup>12</sup> Additional cost will be incurred to maintain the system and to provide the periodic training such a system would require. In addition there are ongoing compliance costs for such a system. These costs may include legal and other professional expertise to counter a contracting officer’s claim of noncompliance.

## **Conclusion**

Small businesses bear a disproportionate share of the regulatory burden. A 2005 Advocacy-funded study by W. Mark Crain entitled *The Impact of Regulatory Costs on Small Firms*<sup>13</sup> found that of the nearly \$1.1 trillion annual regulatory burden, small businesses with less than 20 employees faced an annual regulatory cost of \$7,647 per employee, nearly forty-five percent higher than regulatory costs facing large firms (with 500 or more employees).<sup>14</sup> Given the potential cost and impact of this mandatory compliance regulation on small businesses an IRFA should be prepared for this rule in order to help the Councils develop a more flexible and cost-effective regulation.

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<sup>10</sup> Small Business Subcontracting Report Validation Can Be Improved, GAO-02-166R, December 13, 2001.

<sup>11</sup> DOD Needs Measures for Small Business Subcontracting program and Better Data on Foreign Subcontracts, GAO-04-381, April, 2004.

<sup>12</sup> Dirke Haire, Law Firm of Holland & Knight, telephone conversation 5-16-07.

<sup>13</sup> *The Impact of Regulatory Costs on Small Firms* (September 2005) is available at <http://www.sba.gov/advo/research/rs264tot.pdf>.

<sup>14</sup> Id. at page v.

Advocacy is pleased to forward the comments and concerns of small businesses. Please feel free to contact me or Major Clark at (202) 205-7150 (major.clark@sba.gov) if you have any questions or require additional information.

Sincerely,

Thomas M. Sullivan  
Chief Counsel of Advocacy

Major Clark  
Assistant Chief Counsel

cc: The Honorable Susan Dudley, Administrator, Office of Information and Regulatory Affairs

The Honorable Paul A. Denett, Administrator, Office of Federal Procurement Policy