

June 29, 2004

**Via Facsimile and E-mail**

Mr. Gary M. Jackson, Assistant Administrator  
Office of Size Standards  
U.S. Small Business Administration  
409 Third Street, SW, Mail Code 6500  
Washington, DC 20416

RE: Small Business Size Standards; Restructuring of Size Standards; 69 Fed. Reg. 13130, March 19, 2004.

Dear Mr. Jackson:

The Office of Advocacy submits this comment letter to the U.S. Small Business Administration (SBA) in response to the above-referenced notice of proposed rulemaking. Our comments represent the views of small entities shared with the Office of Advocacy pursuant to our procurement roundtable on April 8, 2004 and subsequent input from small businesses and their association representatives. We respectfully recommend that the SBA postpone its rulemaking and conduct a formal stakeholder process, throughout the country, that will allow the SBA to better analyze the rule's impact on small business. This type of outreach, incorporated into the rulemaking record, is likely to generate additional alternatives to minimize the impacts on adversely affected small businesses.

**I. Advocacy Background**

Congress established the Office of Advocacy (Advocacy) under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration. Section 612 of the Regulatory Flexibility Act (RFA) requires Advocacy to monitor agency compliance with the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act.<sup>1</sup> The RFA requires agencies to analyze the economic impact of proposed regulations when there is likely to be a significant economic

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<sup>1</sup> Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

impact on a substantial number of small entities, and to consider regulatory alternatives that will achieve the agency's goal while minimizing the burden on small entities.<sup>2</sup>

On August 13, 2002, President George W. Bush enhanced Advocacy's RFA mandate when he signed Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations.<sup>3</sup> Executive Order 13272 instructs Advocacy to provide comment on draft rules to the agency that has proposed the rule, as well as to the Office of Information and Regulatory Affairs (OIRA) of the Office of Management and Budget.<sup>4</sup> Executive Order 13272 also requires agencies to give every appropriate consideration to comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion accompanying the final rule's publication in the *Federal Register*, the agency's response to these written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.<sup>5</sup>

## **II. Proposed Revisions to the Size Standard Program and RFA Compliance**

The proposed rule amends 13 Part 121 of the Code of Federal Regulations. These regulations implement the size standards program required by the Small Business Act to establish distinct definitions by which businesses are deemed small and thus eligible to receive a variety of financial, procurement, and business development assistance. The SBA size standards also define which businesses are small for RFA analysis purposes, unless after consultation with our office and opportunity for comment, the regulating agency establishes an alternate size standard for RFA analytical purposes.<sup>6</sup> The current SBA size standards consist of 37 different size levels which apply to 1,151 industries and 13 sub-industry activities in the North American Industry Classification System (NAICS).<sup>7</sup>

The Office of Advocacy recognizes the magnitude of the task before the SBA to revise its size standards program. We appreciate the SBA's intentions to reduce the number of size standards and at the same time simplify the application of SBA's size standards to federal government programs. In general, the SBA is proposing to move from receipt-based size standards to a system that is mainly employee-based, but that also defines a hybrid employee/receipt cap in particular cases. Under the proposal, the standards will range between 50 employees and 1,500 employees. SBA has expressed a strong desire to make sure that the proposed regulations have a neutral impact. There is concern in the small business community that instead of simplifying size standards, this proposal will add confusion and may unintentionally penalize some small entities currently participating in federal programs.

Small businesses have advised Advocacy that the proposed rule could have a negative impact. Some small businesses are concerned that adoption of the proposed size standards will force them to re-tool their businesses and reduce the size of their workforce in order to retain their

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<sup>2</sup> See generally, Office of Advocacy, U.S. Small Business Administration, *A Guide for Federal Agencies: How to Comply with the Regulatory Flexibility Act* (2003).

<sup>3</sup> Exec. Order No. 13272 § 1, 67 Fed. Reg. 53461 (Aug. 16, 2002).

<sup>4</sup> E.O. 13272, at § 2(c).

<sup>5</sup> *Id.* at § 3(c).

<sup>6</sup> 5 U.S.C. § 601(3).

<sup>7</sup> 69 Fed. Reg. 13130.

small business designation. One such example, submitted to the Office of Advocacy in writing, is from Advanced Systems Development, Inc. According to its owner, the company currently has 182 employees and a revenue base of \$17 million. Under the proposed rule, the new size standard would be 150 employees and a \$30 million revenue-based cap. As a result, this company would be required to reduce its workforce to remain a small business for government contracting purposes. Another company, SSI, which provides facility support services, currently has 350 employees and a revenue base of \$20 million. As proposed, the new size standard for this company (NAICS 561210) would be 400 employees or \$40 million. Again, the company would be limited to hiring no more than 50 new employees to remain a small business for government contracting purposes.

According to data provided by Eagle Eye Publishers, Inc., about 8 out of the Department of Defense (DOD) top 25 NAICS categories (ranked by total DOD spending in category for FY 2003) for fiscal year 2003 will reflect a dollar share increase for small businesses. Some categories will increase by as much as 20 percent from the current FY 2003 base. On its face, it appears as though these changes are helpful because they reflect dollar share increases for small business. Unfortunately, the analysis by Eagle Eye Publishers, Inc. reveals that the increased share is likely a result of the fact that companies considered large by current SBA standards will become “small” under SBA’s proposal. The effect of this may be to crowd out existing small businesses. Similarly, some small businesses in the information technology industry have expressed a concern that the proposed dual employee and revenue cap for the industry will disqualify them as small businesses. Currently, this industry has a revenue-based size standard of \$21million. Because of the nature of the industry, these small businesses are already well over the 150 employee standard proposed in the regulation. Finally, under the proposed regulation, businesses that rely upon seasonal and part-time workers will be required to count these individuals as full time employees and thus some businesses may no longer be classified as small.

#### **A. The SBA’s RFA Analysis Does Not Detail the Impact on Small Businesses**

The SBA performed an initial regulatory flexibility analysis (IRFA) of its proposed rule as required by section 604 of the RFA. The IRFA was published for comment in the *Federal Register* with the proposed rule. In its IRFA, the SBA stated that 35,200 new small businesses would become eligible for federal programs and that 34,100 would lose their small business designation.<sup>8</sup> The SBA then concluded that the impact on small businesses would be a positive net effect, because an additional 1,100 firms would gain eligibility under the proposed changes. Under this approach, the SBA is using the benefits of the rule to one group to offset the adverse impacts on another group, and suggest that “small businesses” in general are better off. The SBA’s IRFA would have benefited the proposal by addressing the magnitude of the impacts on the distinct groups and considering alternatives that could further enhance the rule’s benefits and reduce its costs to the respective groups of small businesses. The Regulatory Flexibility Act requires the SBA to further flush out and examine the impact of the rule change on the 34,100 firms adversely affected by it, by industry. As an example, the SBA states that 3.1 percent of child day care centers will no longer be eligible for small business assistance. The SBA does not

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<sup>8</sup> 69 Fed. Reg. 13138.

provide an economic impact of this loss of eligibility for these centers that receive SBA Micro Loans, for instance.

## **B. The SBA Should Revise the Scope of its Analysis**

The RFA requires agencies to consider the economic impact of actions on small entities. Section 601 of the RFA includes small businesses, small organizations, and small governmental jurisdictions in the definition of small entity. In addition to flushing out the proposed rule's impacts on small businesses, the SBA needs to address the impact of its proposed changes on small non-profits organizations and small governmental jurisdictions. Some non-profits are eligible for SBA loan assistance programs, such as Micro and Disaster Loans. An increase in the number of small businesses eligible for SBA financial assistance may impact such small entities. The SBA's IRFA considers only the impact of the action on the affected small businesses without any consideration given to the impact on small organizations and small governmental jurisdictions.

In its analysis of the impacts on small businesses, the SBA does not fully look at the impact of its proposal on the small business participation in its own programs. Quite surely, the changes in the size standards will have an impact on eligibility, and this proposal would benefit from analysis on how SBA programs will be affected.

From a methodological point of view, identifying the impacted class and evaluating the impact involves more than a listing of affected entities. In its IRFA, the SBA suggests that with respect to the restaurant industries, "Full Service Restaurants (NAICS 722110) and Limited Service Restaurants (NAICS 722211) have the largest number of businesses losing eligibility for SBA assistance if this rule were to be finalized."<sup>9</sup> In total, these two industries would lose about 14,600 businesses out of 272,000..." Without impact information, a 5.4 percent loss does not hold much meaning. Alternatively, consider Facility Support Services (NAICS 561210). According to estimates provided to Advocacy by Eagle Eye Publishers, Inc., under the existing standard of \$30 million, small business captures 53 percent of the business in this NAICS category; under the proposed standard of 400 employees with a receipt cap of \$40 million, small business will capture only 27 percent, a 23 percent drop in small business share. This 23 percent drop, whether monetized or not, is the impact that small businesses in that NAICS category may have to bear as a result of the proposed changes. This is only one industry of the many industries that will have its size standard changed as a result of the proposal. The SBA's IRFA needs to provide the public with sufficient information on all of the industries that are being affected by the changes in the size standards.

The IRFA did not identify or evaluate the economic impact of the proposal on small entities with respect to regulatory actions and programs of other Federal agencies. The Small Business Act requires the majority of Federal agencies to use the SBA-defined size standards to determine which businesses are small. In its regulatory impact analysis, the SBA stated that 6 agencies used the SBA size standards for various programs specific to their agencies.<sup>10</sup> However, SBA provided analysis regarding one of the 6 agencies. In addition to analyzing the proposed rule's

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<sup>9</sup> 69 Fed. Reg. 13140.

<sup>10</sup> 69 Fed. Reg. 13139.

impacts on small business eligibility in the other 5 agencies' programs, SBA should analyze the proposal's impacts on small businesses across all federal agencies' use of the SBA size standards for RFA purposes.

### **Conclusion**

In reviewing some of the concerns expressed to my office on SBA's proposal, it makes sense that we recommend SBA postpone its rulemaking. SBA would benefit from a formalized stakeholder process that can generate more data and information useful for the analysis required by the RFA. You can count on my office to assist you in better considering how changes to size standards may benefit small business.

If you have any questions regarding this letter, please contact Major L. Clark, III in my office at (202) 205-7150.

Sincerely,

Thomas M. Sullivan  
Chief Counsel for Advocacy

Major L. Clark, III  
Assistant Chief Counsel for Procurement

cc: Dr. John Graham, Administrator, Office of Information and Regulatory Affairs