

March 29, 2002

Michael McHale  
Associate Administrator  
HubZone Empowerment Contracting Program  
409 Third Street, S.W.  
Washington, DC 20416

Dear Mr. McHale:

RE: Proposed HubZone Rule

The Office of the Chief Counsel for Advocacy of the U.S. Small Business Administration (SBA) was created in 1976 to represent the views and interests of small business in Federal policy making activities.<sup>1</sup> The Chief Counsel monitors agencies' compliance with the Regulatory Flexibility Act (RFA)<sup>2</sup> and works with Federal agencies to ensure that their rulemakings are supported by analyses of small business impact.

This letter is in response to a proposed regulation published on January 28, 2002, in the *Federal Register* entitled, "Small Business Size Regulations; Government Contracting Programs; HubZone Program." The proposed rule is designed to implement legislative changes to the HubZone program and to amend broader SBA regulations on subcontracting limitations and size standards regarding the nonmanufacturer rule.<sup>3</sup>

SBA correctly concluded that the proposed HUBZone regulations would have a significant economic impact on a substantial number of small entities, and prepared an IRFA as required by the RFA. SBA should be commended for its effort because many agencies simply certify that a rule has no impact to avoid having to analyze it thoroughly. While SBA's IRFA is a good first step, it nevertheless falls short in providing small businesses and small entities with a complete picture of the economic impact associated with the proposed rule making.

The requirements of the RFA are not intended to prevent an agency from fulfilling its statutory mandate. Rather, the RFA is intended to assure that the economic impacts are fairly weighed in the regulatory decision making process. To comply fully with the RFA and avoid potential judicial review actions, SBA should address several concerns raised below in its final regulatory flexibility analysis (FRFA), and address others in a

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<sup>1</sup> Pub. L. No. 94-305 (codified as amended at 15 U.S.C. §§ 634a-g, 637).

<sup>2</sup> Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. §§ 601-612).

<sup>3</sup> Section 303(h) of Public Law 100-656 and Section 210 of Public Law 101-574 incorporated into the Small Business Act requires that agency contracts be directed solely to small business manufacturers under set-aside provisions. This requirement is commonly referred to as the Nonmanufacturer Rule. The Small Business Act also contains provisions that allow the Administrator of the SBA to waive this requirement when there are no small business manufacturers or processors available to supply the product to the Federal Government.

supplemental IRFA that may be published in the *Federal Register*.

*Certain Flaws in the HUBZone Analysis Can Be Cured in the FRFA*

SBA's IRFA defines small entities as small businesses pursuant to 15 U.S.C. §§ 632(a)(1) and (2).<sup>4</sup> The RFA's definition includes non-profits and small governmental jurisdictions.<sup>5</sup> The goal of the HUBZone program is intended to stimulate historically underutilized business zones and communities through job creation and capital investment. As such, a broader definition of small entities under the RFA should be incorporated into the agency's final regulatory flexibility analysis (FRFA). The IRFA states that SBA believes that a large percentage of the 30,000 Small Business Concerns (SBCs) will be directly affected by the proposal. Yet, the IRFA does not discuss fully the potential economic impact of the proposed regulation on service disabled veterans, women-owned small businesses, Small Disadvantaged Businesses (SDBs) and 8(a) companies and other programs that are part of the 23% annual procurement goal for SBCs as established in Public Law 105-135.

Changes that incorporate these considerations can cure the IRFA simply by including them in the FRFA, but the issues discussed below were not analyzed at all in the IRFA and should be addressed in a separate supplemental IRFA.<sup>6</sup>

*Supplemental IRFA is Needed to Cure Certain Non-Legislative Changes in the Proposal*

Some of the non-legislative changes should have been the subject of a separate proposed rule. Other agencies have found this process to be very beneficial in removing obstacles to final rule implementation. The proposed amendment to 13 CFR 126.201, *Who does SBA consider to own a HubZone SBC*, may be a positive step to insure that the goals of the HUBZone program are met rule. This section amends the ownership requirements of an HUBZone SBC to include employees who participate in the SBC's Employee Stock Option Plan (ESOP). However, from the information provided in the proposal, it is not possible to ascertain the full impact of this change on small entities. The proposed regulation, while well intended, could create a cost/economic burden on small businesses by requiring them to make a major decision to hire or not to hire qualified employees that are not United States citizens.<sup>7</sup> Under these conditions, what are the economic benefits to

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<sup>4</sup> Generally, a "small business concern" is defined in the Small Business Act as an entity that is independently owned and operated and not dominant in its field of operation.

<sup>5</sup> See 5 U.S.C. § 601.

<sup>6</sup> Advocacy did not recommend simply analyzing the impact of the additional non-legislative requirements in the final regulatory flexibility analysis (FRFA) because the courts have ruled that an agency cannot publish a FRFA where the public has not had an opportunity to comment first on the IRFA. See *Southern Offshore Fishing Association v. Daley*, 55 F.Supp.2d 1336 (M.D. Fla. 1999). Since the public has not had an opportunity to comment on the analysis relating to the nonmanufacturer provisions and other requirements in the rule, Advocacy cannot recommend preparing a FRFA without an IRFA.

<sup>7</sup> The changes proposed by SBA seem to conflict with the requirements of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 et seq. The HUBZone proposal defines a SBC as one that

the small business to participate in the HUBZone program? How does the SBC measure these benefits against the benefits of an ESOP? How many SBCs that are located in HUBZones have ESOPs? How many of these have applied or would apply for certification?

In the discussion of cost contained in the IRFA, SBA states that these changes will not result in significantly higher increased costs to HUB Zone SBCs. The only cost factors discussed are related to the Paperwork Reduction Act, 44 U.S.C., chapter 35. Here, the cost is related to the collection of annual data on the number of employees and updated financial information. However, the IRFA does not discuss costs associated with keeping an accurate system to insure that all employees of an ESOP are United States citizens or that corporations that are HUB Zone SBCs must maintain an accurate system to verify that all stock holders are United States citizens.

Another change contemplated by SBA is a provision expanding contract performance requirements for construction HUBZone contracts. One proposed amendment would require HUBZone SBCs to perform at least 50% of a construction contract through prime or subcontracting arrangements. As another alternative, SBA is considering imposing an evaluation factor in the award of negotiated HUBZone set-asides relating to overall performance by qualified HUBZone SBCs. SBA has requested that concerned parties to provide comments on these alternatives. However, it is difficult to provide meaningful comments without economic impact data. The proposed amendments to 13 CFR 126.700 should therefore be the subject of a supplemental IRFA.

If you would like to discuss this matter, please contact Major L. Clark, III, Assistant Advocate for Procurement Policy. He may be reached at (202) 205-7150, or at [major.clark@sba.gov](mailto:major.clark@sba.gov).

Sincerely,

Thomas M. Sullivan  
Chief Counsel Office for Advocacy

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