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CLIENT ADVISORY

GAO'S DELEX DECISION AND GSA'S RESPONSE: THE CLASH OF TITANS?

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On October 8, 2008, the US Government Accountability Office (GAO) used its recently-expanded bid protest jurisdiction over task orders to breathe new life into the "Rule of Two." In *Delex Systems, Inc.*, B-400403 (Oct. 8, 2008) (*Delex*) GAO sustained a small business protest against a US Navy delivery order solicitation under a large, multi-award, indefinite delivery indefinite quantity (IDIQ) contract. The protester claimed that the agency failed to comply with the Rule of Two set-aside provisions of Federal Acquisition Regulation (FAR) 19.502-2(b), which requires agencies to set aside certain contracts valued at over US$100,000 when there is a reasonable expectation that at least two responsible small businesses can perform the work. Prior to *Delex*, the regulation had been honored mostly in the breach by agencies. GAO, however, determined that the Rule of Two applied to multiple-award IDIQ task and delivery orders and concluded that because the Navy would have received at least two offers from qualified small businesses, the procurement should have been set aside for small business. With that decision, GAO seems to have opened the door to increased contracting for small businesses.

No sooner had the ink dried on GAO's decision, however, than the US General Services Administration (GSA) weighed in and issued a public memorandum regarding the *Delex* decision, and its effect on GSA Schedules task and delivery orders. (*See GSA Memorandum from David A. Drabkin, Senior Procurement Executive to All GSA Contracting Activities*, dated October 28, 2008) (Memo). In its Memo, GSA announces that it "does not agree with GAO's decision in this matter." At first look, this bold statement may seem to signal a head-on collision between GSA and GAO. However, further examination of the Memo reveals that GSA was really voicing a belief that the *Delex* decision ultimately would not apply to GSA's schedule contracts.

GSA DEFLECTS THE EFFECT OF DELEX FROM ITS SCHEDULES

In explaining its "disagreement" in the Memo, GSA stakes out why the *Delex* decision does not in GSA's opinion apply to FAR Parts 8 and 38 federal supply schedule (FSS) contracts. The first reason offered would seem to have little merit. GSA cites Federal Acquisition Streamlining Act of 1994 (FASA) requirements that all contractors be provided a "fair opportunity" to compete for task and delivery orders, and reasons that the Rule of Two would conflict with this FASA mandate. The Navy made a similar argument in *Delex* and GAO rejected it, finding that the Rule of Two is also rooted in a statute (the Small Business Act) and could not be so lightly dismissed.

GSA's second rationale, that it is exempt from the Rule of Two, goes to the heart of the rationale in the *Delex* decision and may have more merit. In *Delex,* GAO found no express exemption from the Rule of Two FAR regulation (FAR 19.502-2(b)) in either the Competition in Contracting Act (CICA) or FASA. In the Memo, GSA reasons that FAR Part 8.4, however, does contain such an exemption, expressly mentioning and exempting FAR Part 19 requirements generally from GSA schedule contracts. As such, GSA's claim seems plausible and consistent with GAO's requirement for such an exemption. However, if GSA is correct, and such an exemption is eventually upheld and validated, GSA's brief Memo may be just the tip of the iceberg on the deeper effects of *Delex* on future federal procurement actions.

GSA'S ANALYSIS

In its Memo, GSA asserts that the GAO decision in *Delex* "was directed to orders issued under multiple award IDIQ contracts awarded under FAR Part 16 and was not applicable to orders issued under Federal Supply Schedule contracts." (*See* Memo at 1). GSA's concern, and the purpose of the Memo, seems to be that "[s]ome personnel, however, may believe GAO's decision can be construed as applying to orders issued under Schedule contracts." (*Id.*). GSA is correct that *the facts* of *Delex* involved only FAR Part 16 IDIQ contracts. However, GSA's overly broad statement that the GAO decision is wholly inapplicable to its FSS contracts appears to overreach, and almost predicts the outcome of any future GAO decisions following *Delex*. Nevertheless, on the merits, GSA's analysis appears to be correct. GSA's Memo cites the type of express waiver in FAR Subpart 8.4 that GAO required in *Delex*. Section 8.4 expressly (though generally) exempts GSA from small business provisions in FAR Part 19. FAR Subpart 8.404(a), which implements FSS, clearly states that the Small Business provisions of FAR Part 19 do not apply to orders issued under the GSA Schedule contracts:

> General. Parts 13 (except 13.303-2(c)(3))), 14, 15, and 19 (except for the requirement at 19.202-1(e)(1)(iii) do not apply to BPAs or orders placed against Federal Supply Schedules contracts… (*See* FAR 8.404(a)).

At the end of its analysis, GSA notes that "further guidance will follow" on this issue. However, to date, GSA has issued no additional guidance, and at this time it is unclear whether GSA's interpretation will stand when challenged in future protests before GAO. However, if GAO in *Delex* was merely looking for an express waiver to justify exemption from the Rule of Two, the general exemption cited by GSA makes a strong case for it.

GSA'S AND DELEX'S POTENTIAL IMPACTS ON FUTURE FEDERAL ACQUISITIONS

The GSA analysis creates an interesting "state of the board" for future acquisitions. The *Delex* decision combines with the GSA Memo to create strategic questions for procurement agencies, GAO, and contractors.

One of the biggest potential issues involves the application of the Rule of Two to large multi-agency contracts (MAC) such as Department of Homeland Security's (DHS's) Enterprise Acquisition Gateway for Leading Edge (Eagle) contract, or the Alliant government-wide acquisition contract (GWAC). For instance, if an agency sets aside portions of a MAC, for large *and* small businesses, questions may arise as to whether this type of *partial* set-aside of the entire requirement satisfies the Rule of Two as upheld in *Delex*. The question is whether FAR Part 19.502-2(b) requires a *total* small business set-aside of the master contract, or whether a partial set-aside of the major/primary contract would suffice. A decision either way could have significant repercussions within federal procurement. On one hand, if GAO holds in the future that a partial set-aside on a MAC does not meet the Rule of Two, this could result in increased legal challenges of the MACs at both GAO and the Court of Federal Claims. This could cause increased delays to procurements and increased agency costs, and might cause agencies to rely less on MACs and more on FSS contracts issued under FAR Subpart 8.4. That is particularly true if the position GSA stakes out in its Memo survives legal challenge. Such a ruling may cause federal agencies to rely

much more heavily on FSS contracts, which do not require set-asides, ironically potentially *shrinking* opportunities for small businesses to compete for government work. That is the opposite effect that the small business community would hope for from *Delex.*

If GAO were to find that such partial set-asides were appropriate, such a ruling might correspondingly *expand* small business opportunities for those types of contracts. However, such a GAO finding might also open the door to other problems, especially if agencies use such partial set-asides to work around the Rule of Two. One ancillary problem would be small business challenges to such agency set-asides. For instance, when an agency issues a partial set-aside of a MAC or IDIQ, it would effectively be indicating that small businesses were incapable of performing the portion reserved for large businesses. Small firms might object to that determination. The proper forum for such challenges would depend on whether such challenges are interpreted as *affirmative* responsibility determinations in favor of the large businesses or whether they are considered *negative* determinations on the capabilities of the small businesses. GAO would be the appropriate forum for agencies' affirmative responsibility determinations, although GAO reviews such challenges only narrowly, if at all. The US Small Business Administration (SBA) has exclusive jurisdiction to review small business capability determinations under the Certificate of Competency (COC) program. How the responsibility determination is viewed would ultimately determine the forum for such challenges. Notably, in the *Delex* case, SBA intervened, examined the capability issue, and ultimately found Delex and other small firms capable to perform the work. The role of GAO and SBA in examining these capability and responsibility issues in future cases is unclear.

If GSA's strong response is any indication, the *Delex* decision will continue to raise significant concerns throughout the government contracts community. At this early stage, we have yet to see the full effect of this ruling, but will have to wait to see how *Delex* plays out. As more decisions unfold, we may get a clearer picture of how these two titans of government contracting—GAO and GSA—resolve the major acquisition issue they have laid before us.

We hope that you have found this Client Advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

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