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FEATURE COMMENT: Congress Considers Procurement Preferences for Medium-Sized Businesses, Though Concerns Persist Regarding International Trade Obligations

Historically, the U.S. has made sweeping efforts to assist small and disadvantaged businesses in federal procurement. Now, the U.S. Congress is considering ways to extend similar assistance to *medium*-sized businesses. Legislation currently before the House Small Business Committee, H.R. 1812, would lend a special preference to medium-sized businesses that participated in the General Services Administration mentor-protégé program. Others have proposed simply extending existing small business preferences to medium-sized businesses, and the Obama Administration has launched a program to facilitate medium-sized businesses' participation in the $500 billion federal procurement market. All of these approaches must, however, be assessed against U.S. obligations under international trade agreements, for some initiatives may trigger concerns—or even retaliation—among major U.S. trading partners.

This article reviews the current initiatives in this area and the three basic options currently open to policymakers seeking to assist medium-sized businesses. The discussion below assesses:

- First, the Obama Administration's "Business Breakthrough" program, under which GSA provides training and advice to medium-sized businesses eager to participate in the federal market. The administration's initiative resembles the European Union's recent efforts to make it easier for small- and medium-sized enterprises (SMEs) to compete in public procurement markets there.
- Second, the discussion reviews another policy option, which, per H.R. 1812, would assist medium-sized businesses indirectly by creating a procurement preference for mid-sized businesses that participated in GSA's mentor-protégé program.
- A third, and potentially more problematic, policy option would be to extend the current preferences for small businesses, perhaps by creating a new, protected category of medium-sized businesses. If it effectively discriminated against foreign vendors, this approach—an extension of the small business program to medium-sized businesses—could raise concerns under existing trade agreements, including the World Trade Organization (WTO) Government Procurement Agreement (GPA). While the U.S. has reserved its right to discriminate in favor of U.S.-based *small* businesses under the GPA, the U.S. has *not* reserved any right to discriminate in favor of *medium*-sized enterprises.

Although there are other means that might be used to assist medium-sized businesses, this article focuses on these three options, because at this point they appear to be receiving the most serious consideration in Washington.

The problem Congress seeks to address—the problem of mid-sized firms in the Government marketplace—really has two aspects. First, there is the problem of "graduating" small businesses, which grow up under the protection of various small business preference programs and then must compete as mid-sized firms, without any preferences or protections. A key problem that has emerged in the U.S. small business program is how to sustain growth in those small businesses, nurtured by the U.S. small business preferences, which grow into "medium"-sized firms and so are no longer eligible for small business procurement preferences. This issue has been an open one for many years. See,

e.g., N. Eric Weiss, "Possible Small Business Issues in the 110th Congress," Congressional Research Service Report No. RS22589, at 4 (Feb. 27, 2008).

Second, and more broadly, mid-sized firms face special competitive obstacles in the federal procurement market, a market which sometimes favors the largest firms, in part because of its steep barriers to entry. There is a perception that mid-sized firms face special difficulties in the Government procurement marketplace, because those mid-sized firms do not have access to the preferences enjoyed by small businesses and because the mid-sized firms lack the economies of scale, and sheer economic muscle, of the largest prime contractors.

The First Policy Option: Making Participation Easier—To even the competitive playing field for those mid-sized firms, the Obama administration launched the "Business Breakthrough Program" in March 2011, through GSA. See Press Release: "White House and GSA Launch New Program to Give Companies a Leg Up in Federal Contracting: New GSA Program to Help Companies Secure and Keep Government Contracts," GSA No. 10780, March 10, 2011, *www.gsa.gov/portal/content/241485*. The program is to provide training and outreach, but *not* any special preferences.

The "Business Breakthrough Program" targets "midsize firms that can get lost in the shuffle between industry goliaths and undersized firms that qualify for Small Business Administration socioeconomic set-aside contract opportunities," according to GSA. See Robert Brodsky, "GSA Launches Program To Educate New and Emerging Contractors," Gov. Exec., March 10, 2011, *www.govexec.com/dailyfed/0311/031011rb2.htm*. According to one White House advisor involved with the program, "We have heard from medium-sized businesses that they are falling through the cracks here. They did not fit the SBA programs, which are geared toward how to get certified as an 8(a) [small business contractor] or as service disabled or women-owned." Id. (quoting Ginger Lew, senior adviser to the White House National Economic Council). According to GSA Associate Administrator Jiyoung Park, the goal of the program is "to increase competition in contracting governmentwide," though without any new preference for mid-sized firms. Id. The Business Breakthrough Program, which is essentially an intensive training program, emphasizes GSA's mentor-protégé program, and is described at *www.gsa.gov/portal/content/239329*.

The administration's recent initiative resembles, in many ways, the EU's parallel efforts to make it easier for SMEs to participate in public procurement markets. In part because of concerns that direct national preferences for SMEs would, in effect, foster discrimination against businesses from other member states, the EU has pressed a more indirect approach, one without direct preferences, but rather one that would reduce barriers to entry. The European Commission has identified a number of barriers to SMEs' successful participation in public procurement, including:

- difficulties in obtaining information on procurements;
- a lack of knowledge about bidding procedures;
- the large size of public contracts to be performed, which favors larger firms;
- brief time spans allowed to prepare bids or proposals, which disfavor smaller firms;
- disproportionately high costs of bidding;
- high administrative burdens;
- unclear jargon in the procurement process;
- burdensome qualification and certification requirements;
- onerous required financial guarantees;
- discrimination against foreign bidders; and,
- difficulties in finding collaboration partners abroad.

See European Commission, Directorate General for Enterprise and Industry, "Evaluation of SMEs' Access to Public Procurement Markets in the EU: Final Report" (Sept. 2010), available at *ec.europa.eu/enterprise/policies/sme/business-environment/public-procurement/*; see also Rhodri Williams, "European Code of Best Practices Facilitating Access by SME's to Public Procurement Contracts," 2008 Pub. Proc. L. Rev. NA249.

Recognizing these barriers to SMEs, and in direct response to the perceived benefits that U.S. law affords small businesses in procurements, the EU in 2008 issued a communication entitled " 'Think Small First': A 'Small Business Act' for Europe," COM(2008) 394 final, SEC(2008) 2101, available at *ec.europa.eu/enterprise/policies/sme/small-business-act/index_en.htm*. Unlike the U.S. Small Business Act, however, the European initiative did *not* stipulate *preferences* for small businesses, but instead outlined ways in which the EU's member states could foster small businesses, from improving access to procurement to easing the impact of bankruptcy. Id.; see, e.g., "Social

and Environmental Policies in EC Procurement Law" (Sue Arrowsmith and Peter Kunzlik, eds., Cambridge Univ. Press 2009); Max V. Kidalov, "Small Business Contracting in the United States and Europe: A Comparative Assessment," 40 Pub. Cont. L.J. 443 (2011); Rosemary Boyle, "EU Procurement Green Paper on the Modernisation of EU Public Procurement Policy: A Personal Response," 2011 Pub. Proc. L. Rev. NA171, NA181; Patrick McGovern, "Ireland: Government Administrative Measures to Support SMEs in Public Procurement," 2011 Pub. Proc. L. Rev. NA6; Martin Burgi, "Small and Medium-Sized Enterprises and Procurement Law: European Legal Framework and German Experiences," 2007 Pub. Proc. L. Rev. 284. Were the U.S. to take up this first policy option—to seek ways to facilitate participation in procurement by both small and medium-sized enterprises—policymakers might wish to look to the European strategies for lowering the barriers to participation.

The Second Policy Option: A Preference for Mentor-Protégé Program Participants—A second policy option would be to use existing mentor-protégé programs as vehicles for assisting medium-sized businesses. On September 14, the House Small Business Committee held a hearing on H.R. 1812, the Small Business Growth Act, sponsored by Rep. Gerry Connolly (D-Va.), and on other legislative proposals that would leverage existing mentor-protégé programs to assist medium-sized businesses.

Mentor-protégé programs, which are sponsored in different forms by different agencies, are generally designed to accommodate both small businesses (the protégés) and the larger firms that enter into formal agreements to assist those small businesses (the mentors). GSA notes that its mentor-protégé program seeks "to assist small business, including small disadvantaged business, veteran-owned, service-disabled veteran-owned, HUBZone, and women-owned small business in enhancing their capabilities to perform contracts and subcontracts for GSA and other Federal agencies." Successful mentor-protégé arrangements, GSA has said, "represent opportunities for creating access for small business to GSA contracts and awards." 74 Fed. Reg. 41060, 41061 (Aug. 14, 2009).

GSA's mentor-protégé program has been criticized for offering too few incentives for medium and large businesses to join the program. 74 Fed. Reg. at 41061; see also General Services Acquisition Manual (GSAM) 519.7004 (discussing incentives for prime contractors to join mentor-protégé program); Anthony Eiland, GSA, Presentation: "The GSA Mentor-Protégé Program," *www.gsaopeningdoors.com/pdfs/Eiland,%20Tony%20GSA.pdf* (discussing practical and legal benefits of joining program). The Department of Defense's mentor-protégé program, which is statutorily authorized, in contrast provides greater incentives for mentor firms to join. See generally U.S. Government Accountability Office, Report No. GAO-11-548R *Federal Mentor-Protégé Programs* (June 15, 2011) (discussing various agencies' programs); *GSA Mentor-Protégé Master Participation List,contacts.gsa.gov/graphics/staffoffices/MentorProtegeParticipationList_10AUG11-EXTERNAL.doc* (GSA reports 76 mentor-protégé agreements). H.R. 1812, which was the subject of the House Small Business Committee hearing, would create special procurement preferences for participants in mentor-protégé programs, and thus would offer strong new incentives to join those programs.

H.R. 1812 would create a pilot program to assist mid-sized firms, as follows:

- H.R. 1812 would direct the Administrator of General Services to establish a five-year small business growth pilot program.
- To be eligible to participate in the program, an entity would have to:
  - be enrolled as a mentor or participating in GSA's mentor-protege program;
  - if participating as a mentor, have at least one protégé that was a small business;
  - have fewer than 1,500 employees; and
  - not be a small business.
- Competitions for GSA contracts could be limited to entities eligible for the program if:
  - The anticipated award price of the contract (including options) was reasonably expected to exceed the simplified acquisition threshold (currently generally $150,000, per Federal Acquisition Regulation 2.101, 48 CFR § 2.101);
  - The contract would otherwise likely be awarded to other than a small business;
  - There was a reasonable expectation that at least two program participants would submit offers; and,
  - The contract could be awarded at a fair market price.
- Contracting officers would be required to consider awarding contracts under the pilot program, before awarding the contract under

full-and-open competition, and could be required to report as to why contracts were or were not awarded under the restricted program.

The legislation would thus create a very strong preference for mid-sized firms that participated as mentors in the GSA mentor-protégé program. On its face, the legislation would seem to require that competitively awarded GSA contracts, if above the simplified acquisition threshold, should *presumptively* be awarded to mid-sized firms enrolled in the mentor-protégé program, if the other criteria outlined above were met. Were H.R. 1812 to become law, it would almost certainly create a crush of applicants for the GSA mentor-protégé program, as mid-sized firms vied to become eligible for this preference.

While technically a protégé would also qualify for the preference program under H.R. 1812, because mentor-protégé programs typically accommodate small businesses as protégés, and small businesses could *not* qualify for the preference under H.R. 1812, it appears that *mentors*, not protégés—i.e., businesses larger than "small," but below the 1,500-employee cap set by the bill—would benefit from the program in the first instance.

Rep. Mike Rogers (R-Ala.) offered an amendment to Title VIII of H.R. 1540, the pending defense authorization bill, which would establish a similar program in DOD, though there for contracts over $25 million. That amendment, however, was not brought to the floor during House debate of the defense authorization bill, which passed the House in May 2011.

The Third Policy Option: Extending Small Business Programs to Mid-Tier Firms—A third means of enhancing medium-sized businesses' access to procurement contracts—access for those firms that exceed the traditional size standards for "small businesses"—would be to expand the definition of "small" business to include those larger firms, or to create a new category of protected "medium-sized" enterprise. H.R. 1812 does not squarely present this issue (the bill does not create a new "medium" category of firms, but instead creates a special pilot program for certain larger-than-small firms), but this option is likely to receive serious consideration as the policy discussions unfold.

The policy debate would have to consider a number of questions, including the following issues that have been raised in policy discussions on Capitol Hill:

- Should a new preference category of "medium-sized" businesses be created, or should existing "small business" categories be expanded?
- Should the acceptable size for these firms be a uniform standard—say, 1,500 or 2,500 employees—or should the size standards vary?
- Should affiliation rules apply, to disqualify firms that are affiliated with other firms and so form much larger joint enterprises?
- Should "size" protests be allowed, so that competitors and others may challenge firms that are apparently improperly benefiting?
- Will the "Rule of Two," which says that eligible procurements must be reserved for small business if it appears two or more small businesses will compete, apply to protected mid-sized firms?
- Should there be a limit on the number of contracts that can be awarded to benefiting firms?
- Would benefiting firms have a priority in preference?
- Will these initiatives enhance competition? Create jobs?

These technical issues were addressed in recent testimony before the House Small Business Committee. See, e.g., Statement of Professor Christopher R. Yukins Before the U.S. House of Representatives Committee on Small Business, Hearing: "Beyond the Size Standards: Sustainability of Small Business Graduates" (Sept. 14, 2011), available at *smbiz.house.gov/UploadedFiles/Yukins_Testimony.pdf*; see also *www.youtube.com/watch?v=BdXa30QnzDc* (video).

As a threshold matter, however, as the discussion below reflects, international trade obligations suggest that Congress should *not* create a new preference category for "medium-sized" businesses, because doing so might trigger international concerns (and even retaliation) among U.S. trading partners. A new category of protected "medium-sized" firms may run afoul of an important WTO agreement, the plurilateral GPA. See generally Office of the U.S. Trade Representative, "WTO Government Procurement Agreement," *www.ustr.gov/trade-topics/government-procurement/wto-government-procurement-agreement* (discussing GPA).

WTO members that join the GPA agree, with conditions, to open their procurement markets to vendors from other members of the GPA. Under the agreement, signatory nations commit (a) not to discriminate against other members' vendors, (b) to treat vendors from other member states as they would their own vendors, and (c) to follow certain procedural minima in conducting covered procurements. The U.S. is a member of the GPA, as are many of the U.S.' key trading partners, including the member

states of the EU, Hong Kong/China, Iceland, Israel, Japan, Korea, Liechtenstein, Norway, Singapore and Taiwan (Chinese Taipei). China is negotiating its accession to the GPA, and India is likely to follow behind China in joining the agreement. The GPA, which has been (in various forms) an important part of U.S. trade policy for many decades, is arguably the cornerstone to opening world procurement markets for U.S. exporters over the coming years. See generally, "The WTO Regime on Government Procurement" (Sue Arrowsmith and Robert Anderson eds., Cambridge Univ. Press 2011); Christopher R. Yukins and Steven L. Schooner, "Incrementalism: Eroding the Impediments to a Global Public Procurement Market," 38 Geo. J. Int'l L. 529 (2007), available at *ssrn.com/abstract=1002446*.

Each nation that joins the GPA reserves certain elements of procurement from the agreement's free trade obligations. The U.S., when it joined the GPA, made a number of reservations, including one vitally important to our discussion here: the U.S. reserved its right to give a preference to U.S. small businesses, even if that means discriminating against foreign vendors seeking to sell to federal agencies. The reservation, which is set forth in the U.S.' General Notes to the GPA, states (in relevant part) that "this Agreement will not apply to set asides on behalf of small and minority businesses." Other GPA member nations have not made similar reservations to protect their small businesses.

The U.S. thus has *not* reserved a right to discriminate against foreign vendors from GPA nations with regard to *medium*-sized businesses. A new, unreserved U.S. preference for procurement from U.S.-based medium-sized businesses also could undermine the U.S.' negotiating position with China and other developing nations, which are seeking broader protections for their own emerging industries before they agree to join the GPA. Moreover, were the U.S. to create a preference for medium-sized businesses, that preference could trigger a challenge by the EU, or other GPA members, under the WTO disputes process. Finally, a new preference for medium-sized enterprises could prompt the EU to demand that its member nations, too, be allowed to extend preferences to European SMEs.

The EU has long criticized U.S. procurement preferences for small businesses, arguing that the preferences in effect wall off European vendors from a major portion of the U.S. federal procurement market. In a 2009 report, for example, European policymakers wrote:

> The active promotion of small businesses is a common concern for the EU and the US. The EU is, however, concerned that the US "set-aside" measures and their exemption from the GPA favour US industry and have exclusionary effects to the detriment of foreign competitors.

European Union, "Market Access Database" (updated March 1, 2009), *madb.europa.eu/madb_barriers/barriers_details.htm?barrier_id=960300&version=5*.

The European comments both reflected concern that small business preferences are excluding foreign vendors *and* hinted at where the EU may go: the EU may demand that it, too, be allowed to erect preferences to protect *European* SMEs from U.S. and other foreign exporters. See Max V. Kidalov, supra, at 445. European preferences "walling off" the market currently occupied by SME's in European procurement could have a substantial impact on U.S. exporters, because a very large share of that market—an estimated 42 percent of all European prime contracting in 2005, for example—goes to SMEs. Id. at 447 & n.12 (citing European Commission, "European Code of Best Practices Facilitating Access of SMEs to Public Procurement Contracts," at 4 (June 25, 2008), available at *ec.europa.eu/internal_market/publicprocurement/docs/sme_code_of_best_practices_en.pdf*). While the EU has so far stopped short of creating SME procurement preferences (as noted, the Euro-

Table: EU Guidelines for Defining Small and Medium-Sized Businesses
Source: *ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm*

Enterprise category	Headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

pean "Small Business Act" instead sought merely to *facilitate* SMEs' participation in public procurement markets), a strong new U.S. preference for "medium-sized" enterprises could trigger a broader European political reaction.

Creating a new protected category of "medium-sized" enterprises may, therefore, raise serious issues under existing trade obligations. One way to reduce the risks of controversy would be to avoid creating a new category, and instead to work within the existing framework of small business preferences. Congress could do so, for example, by revising the size standards for small businesses, to expand those standards to sweep up larger firms. See 13 CFR § 121 (SBA size standards); FAR pt.19, 48 CFR pt. 19 (size standards). This approach, which many advocates for medium-sized enterprises have urged, would not necessarily run afoul of U.S. trade obligations because the key trade agreement, the GPA, does not define "small business." While the EU has generally lower guidelines for defining small business (see table, previous page), those guidelines are not binding on the European member states, and there is no binding international definition for "small business." It appears, therefore, that the U.S. could expand its definitions of protected "small" businesses, to sweep in larger firms.

Although adjusting the size standards to sweep up "medium-size" firms would not necessarily trigger a trade dispute, the issue could be highly contentious because of the collateral impact on firms that did, or did not, qualify under the prospective size standards. See, e.g., U.S. Small Business Administration, Press Release: "SBA Proposes Increase in Size Standards to Help Reflect Changes in Marketplace" (March 13, 2011), available at *www.sba.gov/content/sba-proposes-increase-size-standards-help-reflect-changes-marketplace*; Press Release: "Grassroots Movement Blasts SBA's Proposed New Size Standards: Proposed Size Standards Are No Help to Small Businesses in Key Sectors" (March 12, 2011), available at *www.prweb.com/releases/2011/03/prweb5176354.htm*; "American Institute of CPAs Urges Increase to SBA Size Standard at House Hearing" (May 25, 2011), available at *www.aicpa.org/advocacy/cpaadvocate/2011/pages/aicpaurgesincreasetosbasizestandard.aspx*. Because of their practical impact on affected firms, size standards have traditionally generated heated political debate, and Congress may prove reluctant to step into that field of controversy.

Conclusion—There is an abiding concern that mid-sized firms are disadvantaged in the federal marketplace because of structural forces within that market and because the mid-sized firms may have grown up under the protection of small business preferences. There is also a consensus that mid-sized firms typically provide healthy competition in the federal marketplace. Addressing these concerns by creating a special preference category for "medium-sized" firms could, however, trigger serious trade frictions, and could undermine ongoing efforts to open global procurement markets. Less controversially, therefore, Congress may opt to establish a pilot program, as contemplated by H.R. 1812, to create a procurement preference for participants in the GSA mentor-protégé program, so long as those firms remained under a certain size limit. Alternatively, policymakers may conclude that a prudent initial step would be to ease the burdens on mid-sized firms, as the EU has tried to do, to make it easier for those medium-sized firms to compete for public procurements.

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