United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, DC 20510–6350

March 9, 2000

The Honorable William Cohen
Secretary of Defense
The Pentagon
Washington, DC 20301-1155

Dear Mr. Secretary:

During 1999, most agencies of the Government continued working on the implementation of the new HUBZone program to encourage small businesses to locate in and hire from the nation's most intransigent areas of poverty and unemployment. By enhancing opportunities for small businesses to win Government contracts, the HUBZone program can provide economic vitality to these areas that have been neglected for far too long. We appreciate your efforts to make the HUBZone program a successful one in the Department of Defense (DoD).

At the same time, an outstanding issue needs to be addressed concerning DoD's purchase of commodities. Last year, potential implementation problems were reported to us in this area that could lead to unintended and anti-competitive results. The hypothetical example brought to our attention was in purchases of corn-soy blend for the U.S. Department of Agriculture's (USDA) Food for Peace program. We recount this example because it may be illustrative of similar problems at DoD--problems we seek to ascertain and prevent.

Apparently, corn-soy blend is a commodity with a small number of vendors, of which only one is known to be eligible under the HUBZone program. In procurements awarded through full and open competition, this one company would have been eligible for a 10% price evaluation preference relative to other large business bidders, as provided by section 602(b)(B) of the HUBZone Act (15 USC § 658(b)(3)). Some would argue that, because bids for commodities generally tend to fall within a narrow range of prices, this 10% preference could have been overwhelmingly decisive--although it is not entirely clear that this is as true in the case of processed commodities as for raw commodities. If so, however, a single firm could have secured significant portions of the market for this product at a price much higher than would otherwise have been the case. This, in turn, could encourage other vendors to abandon the corn-soy blend market in favor of other commodities, thus reducing USDA's vendor base and reducing competition--results that would be contrary to the goals of the Small Business Act.

This dire scenario, however, must be tempered by the requirements imposed by other procurement laws. The Competition in Contracting Act of 1984 authorizes an agency to exclude a particular vendor, to maintain alternative sources of supply, if the agency head finds that such exclusion would increase or maintain competition and would likely result in reduced overall costs for such procurement (41 USC § 253(b)(1)(A)). This determination may be made only on specific procurements, not for an entire class of purchases or contracts. (41 USC § 253(b)(4)). If a contracting officer discovers that the HUBZone program is in fact having the anti-competitive effect described previously, that contracting officer should notify his or her agency head whether such a determination might be appropriate. Thus, we do not believe the HUBZone program as enacted necessarily must result in the elimination of competing non-HUBZone sources, provided contracting officers carry out their responsibilities under the Competition in Contracting Act.

In addition, the HUBZone program need not result in an explosion of costs to procuring agencies or to the taxpayers. First, the 10% price evaluation preference is just that: a price evaluation preference. It does not automatically add 10% to the costs of these procurements. It simply establishes a range in which a HUBZone firm may be higher than other large business bidders and remain competitive. A HUBZone firm must still submit competitive bids against other small businesses (against whom the price evaluation preference does not apply at all) and against large businesses, both of whose bids are unknown at the time the HUBZone firm submits its own bid. The HUBZone firm will not want to price itself out of the market by overestimating the effect of the price evaluation preference and submitting a non-competitive bid. Thus, a HUBZone firm will still seek to keep its bid as low as possible. It is not correct that the HUBZone program would add 10% to the price of commodities procurements.

Second, a procuring agency can avoid the price evaluation preference altogether by setting aside a procurement for competition restricted to HUBZone firms. The price evaluation preference does not apply in the case of a HUBZone set-aside. However, this exception would apply only in procurements of commodities in which two or more HUBZone vendors are likely to submit bids.

Finally, both the HUBZone program and the small business program in general tend to restrain, not increase, program costs over the long run. Even if a specific contract may be at a marginally higher price in the short-term, this approach intends to encourage additional small businesses to participate in Government procurement that might have otherwise been unprofitable. Encouraging additional vendors to participate, to develop their infrastructure and human resources, will enable these markets to be more competitive in future years with a larger number of vendors. A small investment now produces big dividends in the future. Any changes that might be necessary in the HUBZone program must take care not to sacrifice these benefits.

The HUBZone program, therefore, does not present the prospect of catastrophic anti-competitive results as portrayed by some critics. The reality is much more nuanced. Nevertheless, the potential for unintended consequences--even if only on a smaller scale--deserves corrective action. To this end, the Chairman supported a proviso in the Fiscal 2000

Agriculture Appropriations conference report to limit the price evaluation preference to 5% in most cases in USDA commodities procurement and to direct USDA contracting officers to observe their responsibilities under the Competition in Contracting Act. This provision in the Agriculture Appropriations bill affected USDA only, however. By this provision, the Chairman sought to avoid those unintended consequences until the matter can be reviewed more comprehensively in our small business reauthorization bill this year.

That time will soon be at hand. To make a more effective policy that will address legitimate concerns and provide guidance both to contracting officers and to vendors, we need additional information on commodities procurements by DoD as well as other agencies. It would be a mistake to set permanent policy for all agencies based solely on the hypothetical example of USDA purchases of corn-soy blend; to do so would risk additional unintended consequences for commodities whose markets may in fact be very different from corn-soy blend and for agencies whose commodities buys may be structured very differently from USDA. We also believe it is important to clarify the HUBZone program's broader application to commodities procurements to remove the uncertainty that currently exists among vendors about the program and to ensure that the program's benefits become more widely available to eligible firms. We would therefore appreciate additional information on DoD's commodities procurements, particularly on the following questions:

(1) What is a "commodity" for purposes of DoD purchasing? Does DoD use one Department-wide definition, or are different definitions of the term applicable to different procuring agencies or specific Services? What criteria are used to determine whether a commodity is a raw commodity or a processed/value-added one? How are "raw" and "processed" defined for commodities? Please provide statutory or regulatory citations for all these definitions. If these definitions appear only in internal circulars or policy directives not published elsewhere, please provide copies of relevant extracts.

(2) Based on dollar volume purchased in the last fiscal year, what are the five largest and five smallest commodities purchased by DoD? What tonnage was purchased for each of these commodities? If data for the last year are not yet available, please use the most recent available. Please also specify which commodities are raw commodities and which are processed or value-added ones. Are these commodities purchased at regular intervals (e.g., weekly, monthly, quarterly) or on an as-needed basis? If as-needed, who determines when a need has arisen to justify a purchase? Is the agency that does the actual purchasing the same one as the agency that determines the existence of a need? Who decides what quantity should be purchased in a given tender? Are purchases made in full and open competition, through small business set-asides, as sole-source contracts, or some combination of these approaches?

(3) For each of the five largest and five smallest commodities mentioned in question (2) above, how many vendors are available to DoD? How many of these vendors are large businesses, and how many are small? How many small businesses are currently located in HUBZone areas (even if not currently certified as qualified HUBZone small business concerns)? Based on the last fiscal year, approximately what percentage of those vendors typically submit bids?

(4) What is a typical price range, per unit of commodity, separating the highest bidder from the lowest bidder for each of these commodities? Please indicate the percentage this represents, as follows:

$$\frac{\text{(Highest bid minus lowest bid)}}{\text{(Lowest bid)}} \quad \text{X} \quad 100\%$$

(5) Please discuss any other issues you consider relevant that would be helpful in clarifying the issues concerning commodity purchases and the HUBZone program.

For ease of review, please re-write each question and thereafter provide your response. Because Congressional consideration of the 2000 small business reauthorization measure is quickly approaching, your prompt response to these questions will be most helpful. Currently a markup of this bill is scheduled for March 21, 2000. Therefore, we request answers to these questions by the close of business on March 17, 2000.

If you have questions about this letter, please contact Cordell Smith of the Small Business Committee majority staff on (202)224- or Damon Dozier of the Small Business Committee minority staff on (202)224- .

Sincerely,

John F. Kerry
Ranking Member

Christopher S. Bond
Chairman