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United States Senate

COMMITTEE ON SMALL BUSINESS

WASHINGTON, DC 20510-6350

November 1, 2000

The Honorable Aida Alvarez
Administrator, Small Business Administration
409 Third Street SW
Washington, DC 20416

Dear Administrator Alvarez:

As Chairman of the Senate Committee on Small Business and the author of the HUBZone Act of 1997, I commend the Small Business Administration for its newest rulemaking to improve and clarify the HUBZone regulations. This letter is submitted to comment on those proposed rules, published in the *Federal Register* of October 3, 2000.

As most of the nation enjoys historic prosperity, we must not neglect the pockets of entrenched poverty and unemployment that do not currently share in that boom. Small business is truly on the front lines in the battle to reclaim these distressed areas, and the HUBZone program can help participating small businesses stabilize, get a firm beachhead, and push back the forces of hardship and despair.

In general, the proposed regulations incorporate changes shown to be necessary by the HUBZone program's experiences to date. Some of these changes are long-overdue, and it is regrettable that this rulemaking has taken so long to proceed. These changes were discussed with my staff on February 10, 2000--nine months ago. Although I understand that crafting legally sound regulations takes time and thought, I caution that undue delay means unnecessarily extended hardship for the distressed communities targeted by the HUBZone program.

Covered agencies. The proposed revision of 13 Code of Federal Regulations (CFR) § 126.101(a) would update this section to reflect the list of Federal agencies covered by the HUBZone program, as modified by the Congress in § 1000(a)(5) of the consolidated appropriations bill for Fiscal 2000 (Public Law 106-113). That provision extended the HUBZone legislation to cover the Departments of Commerce, Justice, and State, and was effective for the fiscal year ending September 30, 2000. It is unfortunate that this rulemaking was not even published before the provision expired.

As of October 1, 2000, the HUBZone program became applicable to all Federal agencies that hire one or more contracting officers. The HUBZone regulations currently recognize this change, at 13 CFR § 126.101(b). It may be useful to retain the old list of agencies in the

regulations, to clarify the program's applicability to any HUBZone contracts awarded prior to September 30, 2000, so it is reasonable to proceed with the proposed change.

State and local participation. The proposed regulation includes a new § 126.101(c), specifying that the HUBZone program does not apply to contracts awarded by State and local governments. This may help clarify the difference between Federal contracting programs and State and local programs, since this is often a source of confusion for small business owners seeking to do business in the confusing world of Federal procurement. The section also helps provide notice to States and localities that they should feel free to use the List of Qualified HUBZone Small Business Concerns (List) if they voluntarily wish to adopt an equivalent program to assist distressed areas under State and local authority. The HUBZone Act expressly states that the List may be provided to any "other entity" that requests it, not just Federal agencies. Small Business Act, § 3(p)(5)(D)(iii). Such an entity undoubtedly may be a State or local requester that voluntarily wishes to use the List for its own procurement purposes.

Accordingly, this provision appears to be authorized under the law and should proceed. I do add one general caveat, however, concerning the reliance of States and localities upon Federal procurement systems. I am aware of proposals that, for example, would allow States and localities to purchase off the Federal Supply Schedules. I am absolutely opposed to such a move, since this would simply transmit the virus of acquisition streamlining into State and local procurement offices. Potentially, such a move could cause a vast increase in the amount of contracting dollars placed with insider firms within the Beltway. This would come at the expense of local firms that have been able to turn to State and local contracts as the Federal contracting environment has become more hostile.

Because the HUBZone program is community-based and ensures that contracts are placed with firms located in particular neighborhoods based on economic needs, the HUBZone program does not present an equivalent danger. It is expressly designed to move contracting dollars out of large, insider, Beltway firms into the hands of small businesses located in distressed areas across the nation. Other contracting approaches that do not provide such a community focus (again, and most notably, the Federal Supply Schedules) cannot and should not replicate this regulatory provision for State and local participation. Thus, I am willing to accept this approach for the HUBZone program without implying any consent to such an approach for any other contracting program.

Principal office. The proposed regulation would revise the definition of "principal office" to provide greater flexibility. The current definition refers to the location where a firm's greatest number of employees perform their work. It makes sense primarily for manufacturing firms that perform their work in a fixed location. However, it does not make as much sense for service or construction industries that may go to their customer's location to perform their work. The proposal would exclude the employees that perform their work at specific job-sites from the

calculation of the “greatest number of employees,” thus making it possible for those employees to move from job-site to job-site, as the contracts warrant, without causing their firm’s principal office to move along with them.

The HUBZone Act does not define the term “principal office,” nor does the legislative history specify a meaning. This leaves flexibility for SBA to make such a regulatory definition as is appropriate for different types of industries, under the Administrator’s general regulatory authority. Small Business Act, § 5(b)(6). The HUBZone program takes a new approach to contracting programs, by including a geographic focus. I anticipate that we will learn from experience what does and does not work in implementing that geographic focus, and SBA should tailor its definition as experience demonstrates the need. The proposed regulation is reasonable and should proceed.

Affiliation. The proposed regulation would eliminate an unduly burdensome requirement in the existing rules concerning affiliation (§ 126.604). This is a long-overdue change and is one we both agreed upon in an exchange of letters last February.

The current provision limits HUBZone participation to firms with no affiliates other than women-owned businesses, 8(a) participants, or other HUBZone firms. In practice, this provision has excluded small businesses that the HUBZone law intended to include.

For example, an otherwise-qualified firm whose building is owned by an affiliated, but ineligible, real estate holding company for tax reasons would be forced to decide whether to give up its known tax advantages for the possibility of receiving a Government contract through the HUBZone program. Most businesses will not consider surrendering a certain benefit in return for a possible one. This provision makes HUBZone participation unattractive to such firms.

The general affiliation rules at § 121.103 are more than adequate to prevent the abuse of the HUBZone program by large firms. The taxpayer-financed benefits of the HUBZone program, like other programs in the Small Business Act, are intended for small firms only. Large businesses setting up small fronts, for the purpose of milking the small business program, would be an abuse. To this end, § 3(a)(2) of the Small Business Act vests the Administrator with authority to establish size standards, and the affiliation rules have been an outgrowth of that authority--to apply those size standards to an entire enterprise that may on paper be divided into small units but which acts as a single whole.

The rulemaking authority at § 3(a)(2) does not, however, vest the Administrator with power to exclude eligible small businesses from the HUBZone program by limiting participation to favored types of small business affiliates, as long as the entire enterprise is small. The revised § 126.204 would recognize the need to ensure that participating firms are in fact small, as the

affiliation rules require, without unduly burdening small firms that would like to participate in the program. This change should be included in the final rule.

Non-manufacturers. The proposed regulations would loosen the HUBZone program's restrictions on participation by non-manufacturers, extending the program to retailers. Under current policy, many such retailers are effectively excluded from the program by the general need to show that they would supply products manufactured by a domestic small business manufacturer, under § 121.406(b)(1)(iii). Making this showing is a difficult task, since the small retailers often are at the mercy of their wholesalers' decisions about where to obtain their goods.

In many distressed areas, a substantial portion of the economic activity taking place is retail, selling necessary products to the population living in those areas. Because those areas tend to be relatively out-of-the-way locations, however, manufacturers are less likely to locate there, preferring sites with greater access to transportation. Exclusively reserving HUBZone benefits to manufacturers thus tends to exclude the small businesses currently in HUBZones from participation.

SBA's proposal seeks to find a middle ground that allows some of the retailers currently in HUBZones to participate in the program. However, this provision needs to be limited to smaller contracts, for two reasons. First, large contracts could provide sufficient incentive for a small business manufacturer to locate in a HUBZone. The HUBZone program seeks to encourage firms to move into HUBZone areas, and the 10% price evaluation preference seeks to overcome the transportation and other costs that currently discourage manufacturers from moving to these relatively out-of-the-way locations. Allowing such large contracts to be filled by retailers would effectively undo these incentives.

Second, the non-manufacturer rule is partially intended to impede the creation of "fronts," or businesses that are nominally small HUBZone firms, but which subcontract most of the contract value to large businesses not located in a HUBZone. This practice would be an abuse of the HUBZone program.

SBA's rulemaking addresses these concerns satisfactorily by placing a \$25,000 lid on the purchases from HUBZone non-manufacturers. Contracts below this lid are not likely to be large enough to entice manufacturers into HUBZones anyway; it makes sense to make these smaller purchases from HUBZone retailers--for whom these small purchases can mean the difference between life and death. Second, these small purchases are not likely to be worth the trouble for a large firm to set up a HUBZone front, so I believe the danger of that abuse is fairly small. As long as SBA maintains a reasonable lid on this provision (and \$25,000 seems about right), I support the proposed change. I would oppose this provision if the lid were removed or were raised much higher.

On a technical note, I suggest clarifying wording to the proposed § 126.601(d). It currently reads:

(d) A qualified HUBZone SBC [small business concern] which is a non-manufacturer may submit an offer on a HUBZone contract for supplies if it meets the requirements under the non-manufacturer rule as defined in § 121.406(b) of this title, and if the small manufacturer providing the end item for the contract is also a qualified HUBZone SBC. However, for HUBZone contracts at or below \$25,000 in total value, a qualified HUBZone SBA may supply the end item of any manufacturer, including a large business.

The underlined text imposes all the requirements of § 121.406(b), including (iii) which is the general provision requiring that goods be supplied from a domestic small business manufacturer. The subsequent clauses are intended to modify or waive that requirement, after the underlined clause imposed the old standard. This can be revised to indicate more clearly that the subsequent clauses are intended as a modification of (iii). Thus, I suggest:

(d) A qualified HUBZone SBC which is a non-manufacturer may submit an offer on a HUBZone contract for supplies if it meets the requirements ~~under~~ *of* the non-manufacturer rule ~~as defined in~~ *at* § 121.406(b)(1)(i) and (ii) of this title, and if the small manufacturer providing the end item for the contract is also a qualified HUBZone SBC. However, for HUBZone contracts at or below \$25,000 in total value, a qualified HUBZone SBA may supply the end item of any manufacturer, including a large business.

Thank you again for your work to improve the HUBZone regulations. I look forward to reviewing the final rules. If you have questions about these comments, please contact Cordell Smith of my Senate Small Business Committee staff on (202)224-5175.

Sincerely,



Christopher S. Bond
Chairman

cc: Michael McHale, Small Business Administration

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