

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2561 Rayburn House Office Building
Washington, DC 20515-6515

MEMORANDUM

To: Members, Subcommittee on Contracting and Infrastructure
From: Jared Golden, Chairman
Date: March 25, 2019
Re: Subcommittee hearing: “Cleared for Take-off? Implementation of the Small Business Runway Extension Act”

The Committee on Small Business Subcommittee on Contracting and Infrastructure will meet for a hearing titled, “Cleared for Take-off? Implementation of the Small Business Runway Extension Act.” The hearing is scheduled to begin at **10:00 A.M. on Tuesday, March 26, 2019 in Room 2360 of the Rayburn House Office Building**. The hearing will examine the Small Business Runway Extension Act of 2018 and the current state of its implementation by the Small Business Administration. Furthermore, the hearing seeks to explore potential solutions to mitigate any implementation challenges and if any steps may be necessary to expand the statute’s reach. Witnesses include:

- Mr. David Black, Partner, Holland & Knight, Tysons, VA
- Ms. Megan C. Connor, Partner, PilieroMazza PLLC, Washington, DC
- Mr. Brian Morales, President, ProCal Lighting, Vista, CA - *Testifying on behalf of the National Electrical Contractors Association
- Ms. Erin Allen, President, Contemporaries, Inc., Silver Spring, MD - *Testifying in her role as a board member on behalf of the Montgomery County Chamber of Commerce

Background

The federal government recognizes two categories of businesses – “small” and “other-than small.” While the United States Small Business Administration (SBA) defines what a “small” business is, there is no federal definition for “other-than-small.” Therefore, this category can encompass firms that barely exceed the SBA’s small business size standards up to the multibillion-dollar household names. Businesses that find themselves in this gap between small and large face challenges when they surpass their designated small size status. Specifically, they no longer qualify for small business contracts (federal contracts restricted to competition among firms qualified as small), are no longer eligible for SBA assistance and now must compete in the open market against the titans of the industry.

In many instances, businesses caught in this circumstance must make difficult choices. They may choose to sell, often at a devalued rate than they had previously held as a small company due to

the loss of that small size status.¹ If these businesses are not acquired and subsumed into the supply chain of larger companies, they may choose to modify their business model, focusing on subcontracting opportunities with other small or large companies.² This path prohibits the firm's ability to gain critical project management skills needed to continue growth.³ Finally, they may fail or deliberately choose to impede their own success so that they may remain small and eligible for small business set-aside contracts.⁴ None of these options contribute to healthy and successful growth of these businesses.⁵ If small businesses are unable to succeed outside of the small business contracting pool of opportunities, this inevitably results in a shrinking industrial base, limited competition against major federal contractors, and a poor return on the investment the federal government has made in these small contractors.

Legislative Actions in the 115th Congress

H.R. 6330, the Small Business Runway Extension Act⁶ (the Act), is legislation that arose from a series of Congressional actions undertaken to examine the problem small businesses have when they grow, or graduate, out of their small size status. In the 115th Congress, the House Small Business Committee held a roundtable on November 14, 2017 hearing concerns from a variety of small businesses, industry groups, and subject matter experts.⁷ Following this discussion, the Subcommittee on Contracting and Workforce held a hearing on April 26, 2018 to further explore the issue and identify potential legislative solutions that may help small businesses successfully bridge the gap between competing in the small business space and the open marketplace.⁸ As a direct result of this legislative record, the Act was introduced on July 11, 2018. The bipartisan bill was designed to allow small firms additional time as a small business to solidify their competitiveness and internal infrastructure to achieve greater success when they eventually must compete against much larger companies.⁹

The Small Business Runway Extension Act

Before the change implemented by the Act, the SBA utilized a 3-year average of annual gross receipts (in calculations using receipt-based size standards) of a company to determine if the company is considered small, under its corresponding North American Industry Classification System (NAICS) code. One of the concerns raised during the hearing on April 26, 2018 was that, because contracts are becoming larger in size and scope, a small business could win a large contract which would cause an unusual spike in revenue for the firm, propelling the firm out of the small size status before it is mature enough to compete against much larger firms. The Act extends the

¹ *Leaving the Nest: Challenges Facing Advanced Small Businesses: Roundtable Before the H. Comm. on Small Bus.*, 115th Cong. (2018) (statement of multiple roundtable participants).

² Tonya Saunders, *The mid-tier paradox: too small to compete, too large to survive*, BLOOMBERG GOV. (May 13, 2016), <https://about.bgov.com/blog/the-mid-tier-paradox-too-small-to-compete-too-large-to-survive/>.

³ *Id.*

⁴ Roundtable, *supra* note 1.

⁵ Please refer to the Committee hearing for more information. *No Man's Land: Middle-Market Challenges for Small Business Graduates: Hearing Before the Subcomm. on Contracting and Workforce of the H. Comm. on Small Bus.*, 115th Cong. (2018).

⁶ P.L. 115-324

⁷ Roundtable, *supra* note 1.

⁸ *No Man's Land: Middle-Market Challenges for Small Business Graduates*, *supra* note 5.

⁹ Public Law No: 115-324.

3-year average to 5 years, building in buffer room for companies to take on additional revenue resulting from these rapid-growth years by spreading the difference over a longer period of time.

The text of the statute modifies the portion of the Small Business Act establishing size standards (15 U.S.C. 632(a)(2)). Under this specific section of the Act, section (a)(2)(C) “Requirements”¹⁰ prescribes statutory timeframes adopted by the SBA to calculate the size of a firm. Section (C)(ii)(II) states that the receipts-based size standard be over a period of “not less than 3 years.” The Act simply amended the words “3 years” to “5 years.”

Implementation of the Act

After the Act was signed into law on December 17, 2018, questions arose as to whether the bill was to take immediate effect. Businesses benefitting from the 5-year change hoped the change would take effect immediately, so they may continue to certify as a small business in 2019. However, interpretation and implementation of the law has been contested.

SBA’s Interpretation of the Act

Shortly after the Act was signed into law, the SBA issued Information Notice No. 6000-180022 on December 21, 2018 concluding that the “Runway Extension Act does not include an effective date,” therefore is “not presently effective and... not applicable to present contracts, offers, or bids until implemented through the standard rulemaking process.”¹¹ Later, during a panel discussion at the 2019 National 8(a) Conference,¹² the SBA’s legal argument evolved. SBA representatives explained that the Act applies to every other agency adopting its own size standard but not the SBA itself. Per the text of 15 USC 632 (a)(2)(C): “Unless specifically authorized by statute, no Federal department or agency may prescribe a size standard for categorizing a business as a small business concern unless such proposed size standard... (iii) is approved by the Administrator.”¹³ The reasoning is that it makes little sense for the SBA to prescribe size standards and then request approval for those standards from itself. In sum, the SBA opines that it has no immediate obligation to update its own receipts-based calculation period since the Act, which modifies section 632(a)(2)(C), does not apply to the SBA. Had Congress modified sections 632(a)(2)(A) or (B), the bill would have taken immediate effect since these sections directly concern the SBA.

Congressional Intent

The Committee Report accompanying the bill, H.R. 6330, clearly states Congress’s intent that H.R. 6330 “...lengthens the time in which the Small Business Administration (SBA) measures size through revenue, from the average of the past 3 years to the average of the past 5 years. This modest modification of SBA’s size formula is designed to reduce the impact of rapid-growth years which result in spikes in revenue that may prematurely expel a small business out of their small size standard.”¹⁴ The language in this report, and as evidenced through the legislative actions taken in the 115th Congress leave no question as to Congress’s intent that the SBA address and modify

¹⁰ 15 U.S.C. 632(a)(2)(C).

¹¹ Emphasis added. SMALL BUS. ADMIN., INFO. NOTICE No. 6000-180022 (2018).

¹² Matthew Schoonover, SMALLGOVCON. (Feb 14, 2019), <http://smallgovcon.com/statutes-and-regulations/say-what-sba-says-the-runway-extension-act-doesnt-apply-to-sba/>.

¹³ Public Law No: 115-324.

¹⁴ Emphasis added. H.R. Rep No. 115-939, at 2 (2018).

its own formula determining size through a receipts-based calculation change from the current 3-year average to a 5-year average.

Legal Analysis

Industry and legal experts found SBA's argument to delay the immediate effectiveness of the Act, based on the lack of an effective date in the bill, questionable.¹⁵ A long-standing principle of statutory interpretation holds that a statute, if silent, is presumed immediately effective unless an effective date is purposefully stated.¹⁶ The Act does not specify an effective date, thus it should have been effective immediately. Additionally, when statute and regulation conflict (as in this instance, the Act specifying a 5-year average versus SBA's regulations specifying a 3-year average) the courts have held that statute supersedes regulation¹⁷ therefore the 5-year calculation should apply.

SBA's secondary argument that Section 632(a)(2)(C) does not apply to them is inconsistent on several fronts. Under a plain reading of the law, the provision applies to *any* federal department or agency. The Small Business Act under section 15 U.S.C. 632(b) defines a "[federal] agency" as that established by section 551(1) of title 5, not including the United States Postal Service or Government Accountability Office. In turn, 5 U.S.C. § 551(1) defines an agency to include "each authority of the Government of the United States, whether or not it is within or subject to review by another agency." This broad definition of "agency" arguably includes the Small Business Administration. Moreover, SBA's interpretation that they are not included in section 632(a)(2)(C) contradicts an acknowledgement made by the SBA earlier that same year that the agency is subject to this section. In a proposed rule establishing the SBA's revised size standards methodology, dated April 27, 2018, the SBA wrote in direct response to public comments proposing alternative ideas to measuring business size: "*Congress directs SBA to establish size standards for manufacturing concerns using number of employees and service concerns using average annual receipts. 15 U.S.C. 632(a)(2)(C).*"¹⁸ This inconsistency in positions, mere months apart, appears to contradict SBA's assertion that the modification made by the Act does not apply to the agency.

Current State of Implementation and Potential Solutions

The SBA intends to go through the rulemaking process to implement the legislation.¹⁹ Notwithstanding the merits of the arguments initially given by the SBA, it is possible that the determination to not give immediate effect to the Act responds to the agency's need to limit any confusion and maintain the status quo while new rules, congruent with the new legislation, are implemented.

¹⁵ Industry stakeholders and legal experts found SBA's argument against immediate implementation dubious; for example: Matthew Schoonover, *Update: SBA says 5-year receipts calculation period not yet effective*, SMALLGOVCON. (Jan 9, 2019), <http://smallgovcon.com/statutes-and-regulations/update-sba-says-5-year-receipts-calculation-period-not-yet-effective/>.

¹⁶ *E.g.*, *Matthews v. Zane*, 20 U.S. 164, 179 (1822).

¹⁷ *E.g.*, *Scofield v. Lewis*, 251 F.2d 128, 132 (5th Cir. 1958).

¹⁸ Emphasis added. Small Business Size Standards: Revised Size Standards Methodology, 83 Fed. Reg. 82, 4 (Apr. 27, 2018).

¹⁹ During a Senate hearing, Ranking Member Ben Cardin urged the Administrator of the SBA, Linda McMahon, to give priority and implement the Runway Extension Act, to which she replied that she would be moving forward with the rulemaking process. *Oversight of the U.S. Small Business Administration*, 116th Cong. (2019).

Yet uncertainty remains as to when the 5-year average, as mandated by the Act, will start to apply. For businesses that would be considered “other-than-small” under the 3-year average, but small under the 5-year average, this delay in implementation has real-world consequences. They are currently considered “other-than-small” and therefore, ineligible for SBA assistance; ineligible to compete for small business set-aside and sole source contracts; and lose any small business socioeconomic certifications they may have held. They must wait until the SBA promulgates its final rules for implementing the Act before they may be reconsidered as small under the 5-year standard. The time it will take SBA to revise its regulations are unknown and firms, in the meantime, find themselves facing the mid-size dilemma the Committee previously explored in the 115th Congress.

This uncertainty could be potentially mitigated by a bill that promulgates an effective date for the Small Business Runway Extension Act. Given that the SBA may take a year or more to promulgate its final rule conforming with the Act, this bill would provide stability and clarity to small businesses by offering a concrete date by which the Act will come to full force and effect, despite the status of the rulemaking process. Such bill would incentivize the SBA to complete the rule-making process sooner. Additionally, the bill could propose a few technical changes that will continue to clarify the application of the 5-year calculation.

Other Considerations

As previously mentioned, the intention of the Act was to protect those small businesses that, due to spikes in revenue, may prematurely be kicked out of their small business standard without being fully prepared to leap into the other-than-small category. While the implementation of the Act is an advantage to those small business, the new 5-year formula created unintentional consequences for mid-tier companies with declining revenues that wish to return to the small business category. This is because the 5-year average would capture earlier high-revenue years, unintentionally inflating the size of these firms which are now unfortunately declining in revenue and growth. For this mid-tier companies, it will take longer to return to the small business status under the 5-year average.

Moreover, companies for which the small business category is determined by number of employees, instead of average of annual gross receipts, have been seeking legislative measures similar to those promulgated in the Act to safeguard themselves from the mid-tier dilemma. As it currently stands, the employee calculation is based on the average number of people employed in each of the business’ pay periods during the preceding 12 months. Company stakeholders argue that making the employee calculation over a longer period than 12 months would better ameliorate the fluctuations that can result from variations in the amount of work available and would shed light as to the true quantity of personnel employed by the company on average.

Conclusion

The Act was intended to be a straightforward, simple solution for a well-documented problem examined by the Committee. The legal interpretation of the effective date of the bill became a subject of contention and disagreement among the small business community and the SBA. This hearing attempts to understand the confusion arising from the implementation of the Act, discuss solutions to mitigate implementation challenges, and examine how to better serve other communities equally or indirectly impacted by the mid-tier dilemma.