

# SMALL BUSINESS CONTRACTING IN THE UNITED STATES AND EUROPE: A COMPARATIVE ASSESSMENT

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## I. INTRODUCTION

On July 27, 2009 the European Commission (EC) issued its annual report, *United States Barriers to Trade and Investment Report for 2008*, where it once again republished its complaint that “small business set-aside schemes, exemplified by the Small Business Act of 1953,” are discriminatory measures that “limit bidding opportunities for EU [or European Union] contractors” in the U.S. procurement market.<sup>1</sup> The EC raised this same concern in at least two preceding editions of this annual report.<sup>2</sup> In light of these persistent complaints by our trading partners, U.S. policymakers in Congress and the executive branch would be well-justified in considering broad questions of comity, such as the extent to which the Europeans themselves have adopted policies and practices that favor small EU firms in government procurement; the relative impact of these practices on the entry of U.S. firms into the EU procurement system; the motives behind the U.S. and EU small business preferences; the extent to which any EU small business practices are worth adopting in the United States as part of procurement reforms; and implications of established small business preferences for future transatlantic trade relations.

As this Article demonstrates, small business has long held a special place in the Western public procurement systems both in Europe and in the United States. Public authorities on both sides of the Atlantic use the demand created by government contracts to stimulate competitive private entrepreneurship and greater economic development within their borders. Indeed, the United States; the EU’s predecessor (the European Community); EU members Austria, Belgium, Bulgaria, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, and the United Kingdom; and European Free Trade Area (EFTA) members Iceland, Norway, and Switzerland are all signatories to the Organization for Economic Co-operation and Development’s 2000 Bologna Charter on Small and Medium-Sized Enterprises Policies. The Bologna Charter “recommend[s] that in developing SME policies . . . SME participation in public R&D programs and procurement contracts [should be] encouraged.”<sup>3</sup>

Throughout the twentieth and the early twenty-first centuries, the United States has been a global leader in small business-friendly procurement poli-

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1. Eur. Comm’n [EC], *U.S. Barriers to Trade and Investment Report for 2008*, at 15 (July 2009), available at [http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc\\_144160.pdf](http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc_144160.pdf).

2. EC, *U.S. Barriers to Trade and Investment Report for 2007*, at 13 (Apr. 2008), available at [http://trade.ec.europa.eu/doclib/docs/2008/april/tradoc\\_138559.pdf](http://trade.ec.europa.eu/doclib/docs/2008/april/tradoc_138559.pdf); EC, *U.S. Barriers to Trade and Investment Report for 2006*, at 11 (Feb. 2007), available at [http://trade.ec.europa.eu/doclib/docs/2007/february/tradoc\\_133290.pdf](http://trade.ec.europa.eu/doclib/docs/2007/february/tradoc_133290.pdf).

3. Org. for Econ. Co-operation & Dev. [OECD], *The Bologna Charter on SME Policies*, June 15, 2000, available at [http://www.oecd.org/document/17/0,3343,en\\_2649\\_34197\\_1809105\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/17/0,3343,en_2649_34197_1809105_1_1_1_1,00.html).

cies. However, such policies also have seen increasing popularity with individual European countries, in pan-European institutions such as the European Space Agency, and with the highest authorities of the European Union, including the European Defense Agency and the European Commission itself. As it turns out, U.S. and European small business preferences in contracting are mainly driven by economic and policy concerns unrelated to foreign trade, such as countering monopolistic practices in one's domestic industrial base, stimulating innovation, remedying past racial discrimination, or promoting employment in local distressed areas. To the extent that small business preferences are used to strengthen domestic industry for international competitiveness, this rationale is generally recognized as legitimate by European government authorities and learned commentators.

In 2003, both the United States and the combined European economies had gross domestic products (GDPs) roughly equal to \$11 trillion.<sup>4</sup> With admission of twelve new members since 2003, the EU now includes twenty-seven countries.<sup>5</sup> The EU's GDP has further grown from \$14.34 trillion in 2006, to \$14.66 trillion in 2007, and to an estimated \$14.82 trillion in 2008.<sup>6</sup> In the United States, the GDP has further grown from \$13.83 trillion in 2006, to \$14.11 trillion in 2007, to an estimated \$14.29 trillion in 2008.<sup>7</sup> Companies known in Europe as small and medium enterprises ("SMEs") and known in the United States as small businesses or small business concerns ("SBs" or "SBCs") account for approximately sixty-five percent of the European GDP and forty-five percent of the U.S. GDP.<sup>8</sup> U.S. small businesses accounted for fifty percent of private, nonfarm GDP from 1998 through 2004, a decline from fifty-eight percent in the 1950s.<sup>9</sup> In the United States, small firms represent over ninety-nine percent of all employers, provide over half the private-

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4. Pub. Affairs Section, EC Delegation to the U.S., *The European Union and World Trade: Basic Statistics on European Trade, Comparison with the United States, Japan and Regional Trading Areas*, at 1 (June 2004), available at <http://www.eurunion.org/profile/EUUSStats.pdf>; see also *European Union Relationship with Each U.S. State*, EUROPA/EUR. UNION [EU], <http://www.eurunion.org/profile/EUUSStats.htm> (last updated Aug. 3, 2010).

5. Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. *History of the European Union: 2000–Today, A Decade of Further Expansion*, EUROPA/EU, [http://europa.eu/abc/history/2000\\_today/index\\_en.htm](http://europa.eu/abc/history/2000_today/index_en.htm) (last visited Aug. 20, 2009).

6. *World Factbook: European Union*, U.S. CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/geos/ee.html> (last visited Jan. 15, 2010).

7. *World Factbook: United States*, U.S. CENT. INTELLIGENCE AGENCY <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html> (last visited Jan. 15, 2010).

8. EUR. ASS'N OF RESEARCH & TECH. ORGS. [EARTO], COMMENTS AND PROPOSALS BY EARTO IN RESPONSE TO COMMISSION COMMUNICATION 4 (2004), available at [http://www.earto.eu/fileadmin/content/03\\_Publications/2004\\_10\\_01\\_EARTO\\_FP7\\_final.doc](http://www.earto.eu/fileadmin/content/03_Publications/2004_10_01_EARTO_FP7_final.doc).

9. Press Release, Office of Advocacy, U.S. Small Bus. Admin., No. 07-12 ADV0, Small Business, Big Contribution: Small Business Continues to Generate 50 Percent of Private Nonfarm GDP (Apr. 16, 2006), <http://www.sba.gov/advo/press/07-12.html> (announcing study results).

sector jobs, and generate over two-thirds of new jobs annually.<sup>10</sup> U.S. small business policies in favor of prime contracting resulted in contract awards that created or retained 654,114 jobs in fiscal year 2008, an increase from 562,000 jobs in fiscal year 2005.<sup>11</sup>

European SMEs appear to be almost twice as represented in the European procurement market as U.S. small businesses are in the U.S. procurement market. European small firms received on average forty-two percent of all prime contracting dollars subject to EU regulation in 2005,<sup>12</sup> while U.S. small firms received slightly more than twenty-three percent of federal prime contracting dollars for fiscal year 2005.<sup>13</sup> Within EU Member States, SME participation “range[d] from 78% and 77% in Slovenia and Slovakia to 35% and 31% in France and the U.K.”<sup>14</sup> These participation levels exceed U.S. participation levels by a magnitude of anywhere from about 50% to almost 400%. The comparison is even less favorable to the U.S. procurement system once it is recognized that contracts subject to European regulation must be large enough to exceed EU thresholds. Currently, for central government entities, these thresholds are set at about €125,000 for supplies and services, and €4.845 million for public works, dropping further to €80,000 and €1 million whenever requirements are split into small lots, but increasing to €193,000 for supplies and services procured by subnational and local authorities.<sup>15</sup> What’s more, the share of U.S. small businesses in U.S. procurement spending has been on the decrease to less than 21.5% in fiscal year 2008 and a slight increase in fiscal year 2009.<sup>16</sup>

Nonetheless, the European Commission, the leadership of the European Parliament, and other European authorities have been increasingly looking for ways to utilize the power of public procurement (representing approximately sixteen percent of the European GDP) to harness its small business sector and

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10. See *411 Small Business Facts*, NAT’L FED’N OF INDEP. BUS. [NFIB], <http://www.411sbfacts.com/speeches.html> (last visited Oct. 10, 2010).

11. See U.S. SMALL BUS. ADMIN., FISCAL YEAR 2010 CONG. BUDGET JUSTIFICATION 62 (2009), available at [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/serv\\_budget\\_2010\\_justification.pdf](http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_budget_2010_justification.pdf).

12. See EC, *European Code of Best Practices Facilitating Access of SMEs to Public Procurement Contracts*, at 4, SEC (2008) 2193 working doc. (June 25, 2008) [hereinafter *Eur. Code of SME Best Practices*], available at [http://ec.europa.eu/internal\\_market/publicprocurement/docs/sme\\_code\\_of\\_best\\_practices\\_en.pdf](http://ec.europa.eu/internal_market/publicprocurement/docs/sme_code_of_best_practices_en.pdf).

13. See *FY 2005 Small Business Goaling Report*, U.S. SMALL BUS. ADMIN. (July 1, 2007), [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/sbgr\\_fy\\_2005.html](http://www.sba.gov/idc/groups/public/documents/sba_homepage/sbgr_fy_2005.html) (also listing exclusions of certain types of procurement contracts from the total federal contracts figure).

14. *Eur. Code of SME Best Practices*, *supra* note 12, at 4.

15. See *EU Procurement Thresholds*, U.K. OFF. OF GOV’T COMMERCE (Jan. 1, 2010), [http://www.ogc.gov.uk/procurement\\_policy\\_and\\_application\\_of\\_eu\\_rules\\_eu\\_procurement\\_thresholds\\_.asp](http://www.ogc.gov.uk/procurement_policy_and_application_of_eu_rules_eu_procurement_thresholds_.asp).

16. See *FY 2008 Small Bus. Goaling Report*, U.S. SMALL BUS. ADMIN., [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/fy2008official\\_goaling\\_report.html](http://www.sba.gov/idc/groups/public/documents/sba_homepage/fy2008official_goaling_report.html) (last visited Oct. 4, 2010).

to carry out broader socioeconomic objectives.<sup>17</sup> Because governments in the United States and Europe (including individual European governments) are concerned with economic competitiveness and development, they recognize the unique economic and social contributions of small business as well as the unique challenges faced by small firms.

Over time, all public authorities are eventually confronted with the question of the proper role of small business in public procurement. Although the Government as a buyer takes on many attributes of commercial firms, the activities of the Government in buying goods and services do not represent free market activities. The Government is spending public funds for public purposes. As a result, the taxpayers through their elected representatives (or, in the case of Europe, through national governments) may demand accountable decision making in procurement and fair return in the form of work funded through government contracts. Often, the Government is buying the “public goods” that the market would not otherwise supply in the same way, the same manner, or the same quantities the Government sets in response to public priorities.<sup>18</sup> Further, while and, in part, because the government buyer imposes

17. See *Pre-Commercial Procurement: Key Figures*, EC, [http://cordis.europa.eu/fp7/ict/pcp/key\\_en.html](http://cordis.europa.eu/fp7/ict/pcp/key_en.html) (last updated Feb. 10, 2009); David Manners, *Europe Under Fire for Freezing SMEs out of Public Procurement Contracts*, ELECTRONICS WKLY. (Dec. 3, 2003), <http://www.electronicsweekly.com/Articles/2003/12/03/31353/Europe-under-fire-for-freezing-SMEs-out-of-public-procurement.htm> (citing data from the European Federation of High-Tech SMEs); *Successes and Failures 2004–2009*, EUR. PEOPLE'S PARTY GROUP IN THE EUR. PARLIAMENT (May 31, 2009), [http://www.eppgroup.eu/Policies/imco/policy\\_en.asp](http://www.eppgroup.eu/Policies/imco/policy_en.asp); *Commission Aims to Make Public Procurement More “SME Friendly”*, CLIENT UPDATE (Matheson Ormsby Prentice, Dublin, Ireland), July 15, 2008, available at <http://www.mop.ie/whats-new/publications.asp>.

18. For the industry, public goods are “instances in which marginal private net product falls short of marginal social net product, because incidental services are performed to third parties from whom it is technically difficult to exact payment.” Abraham Bell & Gideon Parchomovsky, *A Theory of Property*, 90 CORNELL L. REV. 531, 560 (2005) (citing ARTHUR CECIL PIGOU, *THE ECONOMICS OF WELFARE* 183–84 (Transaction ed., 2002)). Some commentators have argued that public procurement is a market for items that constitute or resemble pure public goods:

Government contracts frequently involve the construction of what economists call “public goods.” Public goods are items—such as bridges, roads, and dams—which everyone is entitled to use whether or not they pay for the item. Thus, no market incentive exists to create such goods, because by definition even those who fail to pay for the good may benefit. . . . Thus, both theoretically and practically, government projects have no market value because the public has no incentive to purchase them.

Hal J. Perloff, Comment, *The Economic-Waste Doctrine in Government Contract Litigation*, 43 DEPAUL L. REV. 185, 225 n.302 (1993).

Others have argued that the means by which the Government provides public goods involves both pure public good-type items and commercial items that are bought in a different manner:

Government agencies purchase essentially two kinds of goods and services. The first consists of off-the-shelf commodities and services that are routinely bought and sold in ordinary commercial settings. The second is made of specialized products such as weapons systems. . . . Even for the off-the-shelf goods and services, however, government procurement statutes and regulations sometimes may result in a definition of a relatively narrow relevant market by restricting the range of firms that can compete for specific contracts. . . . Specialized goods and services usually present more difficult market definition/market power issues. For many nonstandard items, particularly military hardware, the government is virtually the sole purchaser.

significant regulatory compliance burdens and resembles a monopsonist, the government procurement industry tends towards monopolistic or oligopolistic consolidation and concentration.<sup>19</sup> These factors bring additional influences to bear on the private markets, with the potential to strongly encourage or strongly discourage economic activity by many private enterprises.<sup>20</sup>

There are both numerous similarities and differences among the small business-specific procurement policies developed by the U.S. Government and by the various levels of government in Europe. As shown below, these policies are rooted in the peculiar public procurement systems created on both sides of the Atlantic and in the specific economic, social, or other goals that public authorities hoped to accomplish. This Article will examine small business procurement policies across several key considerations, including the overall policy framework, definitions of small firms, creation of specialized institutions to assist small business with breaking into public procurements, access of small firms to suitable contracts, increasing transparency, promotion of economic and social sustainability, stimulation of innovation, and

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WILLIAM KOVACIC & JOE SIMS, SECTION OF ANTITRUST LAW, AM. BAR ASS'N, *THE ANTITRUST GOVERNMENT CONTRACTS HANDBOOK* 32–33 (1990).

19. See KOVACIC & SIMS, *supra* note 18, at 35 (“The government is not an ordinary purchaser, and it often is the only buyer (a monopsonist) for specialized equipment in question.”). For instance, according to the U.S. Government Accountability Office (GAO), the U.S. Department of Defense (DoD) has actively encouraged and supported consolidation in the U.S. defense industrial base. See U.S. GEN. ACCOUNTING OFFICE, GAO/NSIAD-98-141, *DEFENSE INDUSTRY: CONSOLIDATION AND OPTIONS FOR PRESERVING COMPETITION* 1–2 (1998) (“The sharp decline in spending by DoD since 1985 has resulted in a dramatic consolidation of the defense industry, which is now more concentrated than at any time in more than half a century. . . . Since 1990, there has been a dramatic reduction in the number of prime contractors in 10 of the 12 markets DOD identified as important to national security. . . . This concentration was not unexpected. DOD has encouraged the defense industry to consolidate facilities and eliminate excess capacity to remain competitive and financially viable.”). The European defense market has a similar structure. See MARTIN TRYBUS, *EUROPEAN DEFENCE PROCUREMENT LAW: INTERNATIONAL AND NATIONAL PROCUREMENT SYSTEMS AS MODELS FOR A LIBERALISED DEFENCE PROCUREMENT MARKET IN EUROPE* 24 (Kluwer Law Int'l 1999) (“The economic characteristics of the defence sector are monopsony, the high costs of defence equipment, and the necessity to take life-cycle costs into account. . . . The defence sector is characterized as a monopsony. This means that the producers of hard-defence material often have only one prospective customer for their products: the government. Only their national government or, through exports, a foreign government will buy the equipment.”).

20. When the Government actively facilitates industrial base consolidation, its actions have tended to reduce competition, create significant financial risks for small firms at all tiers, and empower large suppliers to misuse market power by keeping out better innovations and solutions from small firms. See Gillian M. Marks & Norman J. Fry, *Commercialization in Defense Sourcing and Other Responses to Post-Cold War Defense Industry Transformation*, 38 *Geo. J. Int'l L.* 577, 586–88 (2007) (noting DoD has supported consolidating the defense industry as long as such efforts produced efficiencies and did not significantly reduce competition, but also arguing that this DoD-driven consolidation prevents long-term growth of small hi-tech defense firms and instead facilitates acquisitions of these small firms or their technologies by large prime contractors). A particular risk that consolidation of the defense industry presents is that an entrenched supplier with a vested economic interest in a particular technology may use its financial or political influence to prevent adoption of a competing, superior technology developed by a small, innovative firm.

related considerations. Although attempts will be made to make comparisons between policies that are representative of the U.S. approach and one or more European approaches, this Article is not meant to provide a comprehensive review of small business procurement laws and regulations in every U.S. government agency or in every European country. While the recently enacted Small Business Jobs Act of 2010 directs major pro-competition, pro-accountability, and pro-integrity reforms in U.S. small business procurement policy,<sup>21</sup> it will take time for most of its provisions to be translated into federal regulations and policies. In addition, the role of political considerations in developing small business procurement policy is outside the scope of this Article.

## II. SMALL BUSINESS PROCUREMENT POLICY: GENERAL FRAMEWORK

In order to understand the similarities and differences between the details of policies on small business contracting in the United States and in Europe, it is necessary to start by examining the fundamental principles that drive these policies. Once this is done, it becomes clear that fundamental small business contracting principles in the United States are, by and large, mutually reinforcing. In Europe, fundamental SME contracting principles are, by and large, in tension.

### A. *The U.S. Approach: Maximum Practicable Opportunity to Ensure Fair Share*

The U.S. small business procurement policy is generally set in section 1 and other provisions of the Small Business Act of 1953<sup>22</sup> as binding law. This law emphasizes “full and free competition” as the “essence of the American economic system of private enterprise.”<sup>23</sup> The law notes that such unfettered competition is essential for achievement of pro-competitive economic goals such as “free markets” and “free entry into business.”<sup>24</sup> The Act also notes the social goals of increasing “opportunities for the expression and growth of personal initiative and individual judgment” and the defense policy goal of strengthening “the security of this Nation” through “preservation and expansion of such competition.”<sup>25</sup> The Act further directs the Federal Government

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21. See Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504 (to be codified at 15 U.S.C. §§ 631 et seq.). Most procurement-related reforms in this law were initiated in the U.S. Senate Committee on Small Business and Entrepreneurship starting in 2006. See generally Small Business Contracting Revitalization Act of 2007, S. 2300, 110th Cong. (2007); *Strengthening Participation of Small Businesses in Federal Contracting and Innovation Research Programs: Hearing Before the S. Comm. on Small Bus. and Entrepreneurship*, 109th Cong.; S. REP. No. 111-343 (2010); S. REP. No. 109-361 (2006).

22. 15 U.S.C. §§ 631–657o (2006).

23. *Id.* § 631(a).

24. *Id.*

25. *Id.*

“to use all practical means and to take such actions as are necessary . . . [to] reduce the concentration of economic resources and expand competition.”<sup>26</sup>

To implement these goals, the Act embraces two related principles to govern the awards of federal contracts and subcontracts. These policy principles emphasize the need for fairness to small contractors, both from the standpoint of acquisition planning, strategies, and process, as well as from the standpoint of measurable outcomes and results.

The first such principle is the principle of “maximum practicable opportunity” to participate in federal contracts and subcontracts:

It is the policy of the United States that small business concerns . . . shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems.<sup>27</sup>

The “maximum practicable opportunity” principle is generally implemented through process-type actions such as developing procurement strategies, subcontracting plans, and award procedures; publicizing procurement opportunities; providing small firms with information on procurement laws and regulations; breaking up large or complex contracts; and reserving or setting procurement opportunities aside for small firms.<sup>28</sup>

The second such principle is the principle of “fair proportion,” set forth as follows:

It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government (including but not limited to contracts or subcontracts for maintenance, repair, and construction) be placed with small-business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation.<sup>29</sup>

The “fair proportion” principle is generally implemented through planning measures such as contracting and subcontracting goals established by Congress, the president, federal buying agencies, and the Small Business Administration, as well as through accountability reporting such as the annual Small Business Procurement Scorecard.<sup>30</sup>

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26. *Id.* § 631a(a).

27. *Id.* § 637(d)(1) (also listing specific small business categories); *accord id.* § 644(e)(1) (“To the maximum extent practicable, procurement strategies used by the various agencies having contracting authority shall facilitate the maximum participation of small business concerns as prime contractors, subcontractors, and suppliers.”).

28. See, e.g., *Recognizing Best Practices in Increasing Opportunities for Small Businesses*, U.S. SMALL BUS. ADMIN., [http://www.sba.gov/aboutsba/sbaprograms/goals/SBA\\_GOALING\\_BEST\\_PRACTICE.html](http://www.sba.gov/aboutsba/sbaprograms/goals/SBA_GOALING_BEST_PRACTICE.html) (last visited Oct. 5, 2009).

29. 15 U.S.C. § 631(a).

30. See, e.g., *Small Business Prime Contracting Achievement and Small Business Procurement Scorecards*, U.S. SMALL BUS. ADMIN., <http://www.sba.gov/aboutsba/sbaprograms/goals/index.html> (last visited Oct. 5, 2009).

In practice, these two principles and their implementing measures are often intertwined and conflated. As will be discussed below, this is a distinctively American approach, as the Europeans historically have sought to distinguish between measures assuring opportunity and measures assuring a certain participation share to their SMEs. Examples of such conflation in the United States include agency-specific fair share goals and set-asides of specific contracts or classes of contracts to achieve those goals.<sup>31</sup> For instance, in interpreting the so-called Rule of Two in the Federal Acquisition Regulation (FAR), which requires agencies to set aside any contract above \$100,000 unless there is no reasonable expectation of receiving fair-priced offers from two or more small businesses, the U.S. Government Accountability Office (GAO) explained that “the Rule of Two is intended to implement the Small Business Act language in 15 U.S.C. § 644(a) . . . requiring that small businesses receive a ‘fair proportion of the total purchases and contracts for property and services for the Government’” or to support national defense.<sup>32</sup> In procurements that were purportedly exempt from the Small Business Act’s set-aside requirements by executive branch regulations, such as the Federal Supply Schedule task order competitions, small business size can nonetheless be used as a significant evaluation factor on an order-by-order basis.<sup>33</sup>

It must be noted that the U.S. small business procurement policy is a federal policy that exists within the constitutional framework of separate state and federal sovereignties.<sup>34</sup> For this reason, in the United States, the states and the Federal Government maintain separate public procurement systems. Therefore, the U.S. procurement system at the national level does not, in general, regulate procurements by the states. One notable exception is small and minority business preferences in federally funded contracts awarded by states and local governments under President Ronald W. Reagan’s Executive Order 12432, Minority Business Enterprise Development.<sup>35</sup> The most well known of such preferences is the Disadvantaged Business Enterprise (“DBE”) program of the U.S. Department of Transportation and the U.S. Small Business Administration (SBA), which promotes participation by small minority-owned and women-owned firms in federally funded highway projects by requiring expenditure of at least ten percent of highway funds for projects with such firms.<sup>36</sup>

31. See 15 U.S.C. § 644(a), (g).

32. See Delex Sys., Inc., B-400403, 2008 CPD ¶ 181, at 5 (Comp. Gen. Oct. 8, 2008) (citing 15 U.S.C. § 644(a) and FAR “Rule of Two”: Requirements for Setting Aside Acquisitions for Small Business, 49 Fed. Reg. 40,135 (proposed Oct. 3, 1984)) (interpreting FAR 19.502-2(b)); accord Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 1331, 124 Stat. 2504, 2541 (to be codified as 15 U.S.C. § 644(r)) (confirming that small business reservations of awards and task orders on multiple-award contracts are authorized).

33. FAR 8.405-5.

34. See U.S. CONST. amend. X.

35. Exec. Order No. 12432, 48 Fed. Reg. 32551 (July 14, 1983).

36. See, e.g., 49 U.S.C. § 47113 (2006); *Memorandum of Understanding Between the U.S. Small Business Administration and the U.S. Department of Transportation*, U.S. DEP’T OF TRANSP. (Nov. 23, 1999), <http://www.osdbu.dot.gov/DBEProgram/memofunder.cfm>.

B. *The European Approach: Tension Between Fair Access, SME Competitiveness, and Fair Return*

In Europe, the small business policy—more accurately, SME policy—with regard to public procurement has been undertaken both by the European Union government bodies as well as by national and local governments. The European Commission restated its historic approach to small business procurement as follows:

Small and medium-sized enterprises are a unique source of innovation and competition in the internal market and account for 99.8% of the total number of EU enterprises. The European Commission has always paid particular attention to them. By facilitating their access to procurement opportunities, EU procurement policy allows those firms to strengthen their competitiveness and enables them to contribute more towards growth, employment, and competitiveness of the European economy. Commission action has mainly been focused on creating a level playing field where bids from firms, whatever their size or origin, have similar chances of success. Since the early 1990s, measures have been focused specifically on SME's needs in terms of simplification, information, services support, and promoting cooperation between SMEs on contracts.<sup>37</sup>

In 2000, the European Council set in motion a long-term reform of procurement and other policies throughout EU Member States by adopting The European Charter for Small Enterprises (“European Charter”).<sup>38</sup> The European Charter directed the EC and Member States to “pursue the reforms underway aiming at the completion in the Union of a true internal market, user-friendly for small business, in critical areas for development of small businesses including . . . public procurement.”<sup>39</sup>

Historically, European efforts to promote small business procurements have been subject to a number of legal constraints. Arguably, these constraints stemmed primarily from various provisions of the Treaty Establishing the European Community (“EC Treaty”), now called the Treaty on the Functioning of the Union,<sup>40</sup> and of the procurement directives adopted and

37. EIM, THE ACCESS OF SMEs TO PUBLIC PROCUREMENT CONTRACTS: FINAL REPORT 5 n.2 (2004) [hereinafter EIM FINAL REPORT], available at [http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc\\_id=3687&userservice\\_id=1&request.id=0](http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=3687&userservice_id=1&request.id=0) (citing EC, *Promoting SME Participation in Public Procurement in the Community*, SEC (92) 722 final (June 1, 1992)); EC, *Promoting SME Participation in Public Procurement in the Community*, COM (90) 166 final (May 7, 1990); Press Release, EU, IP/98/233, Public Procurement: Commission Communication Outlines Policy Priorities (Mar. 11, 1998), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/98/233&format=HTML&aged=1&language=EN&guiLanguage=en>.

38. See Eur. Council, The European Charter for Small Enterprises (June 19–20, 2000), available at [http://ec.europa.eu/enterprise/policies/sme/files/charter/docs/charter\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/files/charter/docs/charter_en.pdf).

39. *Id.*

40. See Presidency Conclusions, Brussels European Council, at 15 (June 21–22, 2007), available at [http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ec/94932.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/94932.pdf) (“The Reform Treaty will contain two substantive clauses amending respectively the Treaty on the European Union (TEU) and the Treaty establishing the European Community (TEC). The TEU

applied by the European Parliament and Council with Commission involvement.<sup>41</sup> The EC Treaty “covers all public-sector procurement contracts with the European Community, no matter what their value. The EC Treaty sets down principles to prevent discrimination against firms from any Member State.”<sup>42</sup> Contracts above various monetary thresholds established by the European Commission are regulated by the Commission’s procurement directives. Specifically, the Treaty-based constraints are known as the “four freedoms:”

Article 6 (prohibiting discrimination on grounds of nationality), Article 30 (free movement of goods), Article 48 (free movement of workers), and Articles 52 and 59 (freedom to provide services and the freedom of establishment). These provisions prohibit not only *direct* discrimination on the basis of nationality, but also treatment by a Member State which in *effect* discriminates against, or does not provide equal treatment to, a person or entity from another Member State. The importance of these provisions is that they provide a binding standard against which to consider *all* public procurement decisions by public contracting authorities.<sup>43</sup>

For instance, in 1992 and 1993, the European Court of Justice invoked these “four freedoms” in two cases, *Commission of European Communities v. Italian Republic*<sup>44</sup> and *Commission of European Communities v. Denmark*,<sup>45</sup> to invalidate national and local percentage-of-work, main-office-location, labor, materials, goods, and equipment preferences that effectively favored or could have favored local SMEs.

European legal scholars disagree on whether these principles, as interpreted by the European Court of Justice and the European Commission, would extend to situations where preferences are available to SMEs without facial or as-applied discrimination on the basis of nationality. However, the weight of authority and logic appears to fall on the side favoring SME preferences as compatible with the EC Treaty. Perhaps the strongest European Court of Justice precedent directly supporting SME set-asides and preferences is

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will keep its present name and the TEC will be called *Treaty on the Functioning of the Union*, the Union having a single legal personality. The word ‘Community’ will throughout be replaced by the word ‘Union’; it will be stated that the two Treaties constitute the Treaties on which the Union is founded and that the Union replaces and succeeds the Community.”). Because most literature cited here refers to the former “EC Treaty” name, that reference will be used.

41. See *Application of Community Law: What Are EU Directives?*, EC, [http://ec.europa.eu/community\\_law/introduction/what\\_directive\\_en.htm](http://ec.europa.eu/community_law/introduction/what_directive_en.htm) (last updated May 18, 2010) (describing the process by which the EU law is adopted).

42. U.K. SMALL BUS. SERV. & U.K. OFFICE OF GOV’T COMMERCE, TENDERING FOR GOVERNMENT CONTRACTS: A GUIDE FOR SMALL BUSINESS 2 (3d ed. 2004) [hereinafter U.K. TENDERING GUIDE], available at [http://compete.croydonenterprise.com/documents/Supplying\\_Government\\_-\\_a\\_guide.pdf](http://compete.croydonenterprise.com/documents/Supplying_Government_-_a_guide.pdf).

43. Christopher McCrudden, *Social Policy Issues in Public Procurement: A Legal Overview*, in PUBLIC PROCUREMENT: GLOBAL REVOLUTION 219, 223 (Sue Arrowsmith & Arwel Davies eds., 1998).

44. Case C-360/89, *Comm’n v. It.*, 1992 E.C.R. I-3415; see McCrudden, *supra* note 43, at 223–24.

45. Case C-243/89, *Comm’n v. Den.*, 1993 E.C.R. I-3353; see McCrudden, *supra* note 43, at 223–24.

*Commission of European Communities v. French Republic*,<sup>46</sup> which validated mandatory SME participation on bidding teams imposed in order to reduce local unemployment.

The European Commission's procurement directives further implement the Treaty by establishing "procedural and substantive requirements to those public contracts above a certain value."<sup>47</sup> The EC Treaty and the European Commission directives have provided the overall framework for small business procurement policies of the Member States and their political subdivisions.

Over the last five years, European authorities attempted to minimize Treaty-based and policy-based constraints by issuing at least two legally binding directives that expressly authorize and direct various forms of targeted procurement assistance to SMEs: Directive 2004/18/EC of March 31, 2004, On the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts, and Public Service Contracts ("Public Procurement Directive" or "Classic Directive"),<sup>48</sup> and Directive 2009/81/EC of July 13, 2009, On the Coordination of Procedures for the Award of Certain Works Contracts, Supply Contracts, and Service Contracts by Contracting Authorities or Entities in the Fields of Defense and Security, and Amending Directives 2004/17/EC and 2004/18/EC ("Defense Procurement Directive").<sup>49</sup> EU Member States are required to achieve compliance with the Public Procurement Directive by January 31, 2006,<sup>50</sup> and with the Defense Procurement Directive by August 21, 2011.<sup>51</sup> Both directives recognize that such assistance would be appropriate and desirable. In particular, the Defense Procurement Directive called on Member States to limit exclusions of defense items from European Commission directives and rules as authorized under article 296(1)(b) of the Treaty<sup>52</sup> in the

46. Case C-225/98, Comm'n v. Fr. Republic (*Nord Pas de Calais*), 2000 E.C.R. I-07445.

47. McCrudden, *supra* note 43, at 225.

48. Council Directive 2004/18/EC, 2004 O.J. (L 134) 114, 114 [hereinafter Public Procurement Directive], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:134:0114:0240:EN:PDF>.

49. Council Directive 2009/81/EC, 2009 O.J. (L 216) 76 [hereinafter Defense Procurement Directive], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:216:0076:0136:EN:PDF>.

50. Public Procurement Directive, *supra* note 48, art. 80.

51. Defense Procurement Directive, *supra* note 49, art. 72.

52. As explained by Professor Martin Trybus:

Defence spending can be separated in two categories. The first is so-called "hard-defence material," for example, battle tanks, fighter aeroplanes, and warships, which can be used for military purposes only. This is excluded from the EC Treaty by Article 296(1)(b). . . . The second category is the so-called "dual-use material" or "soft-defence material," for example, cross-country vehicles, transport aircraft, and rescue ships, which can be used for military or civil purposes. This is covered by the EC Treaty and the directives, although some contracts for this material may fall within derogations from the Treaty and its directives which provide for protections of national security concerns, such as Articles 30, 39(3) and 46(1) EC (formerly Articles 36, 38(3) and 56(1)). . . . Civil goods purchased by the defence procurement authorities, for example, office equipment, are also covered. Thus the Community has jurisdiction over the market for dual-use material and civil goods but not over that for hard-defence material—a very weak position.

TRYBUS, *supra* note 19, at 17.

“context” of promoting the European Defense Technological and Industrial Base, including support for SME defense suppliers.<sup>53</sup>

The Public Procurement Directive “is based on [European] Court of Justice case law, in particular case law on award criteria, which clarifies the possibilities for the contracting authorities to meet the needs of the public concerned, including in the environmental and/or social area, provided that such criteria are linked to the subject matter of the contract, do not confer an unrestricted freedom of choice on the contracting authority, are expressly mentioned, and comply with fundamental principles” of the Treaty Establishing the European Community such as free movement of goods, free establishment of business, equal treatment, nondiscrimination, proportionality, and transparency.<sup>54</sup> The Classic Directive recognized that social considerations, including SME participation, can be made part of the contracting process in two circumstances. The first circumstance involves including social consideration as part of award criteria when awards are made on the “most economically advantageous tender,” or best value for money, basis.<sup>55</sup> The second circumstance includes imposition of social contract performance conditions to which contractors must agree regardless of whether the award is made on the lowest price basis or the most economically advantageous tender/best value basis.<sup>56</sup>

The Defense Procurement Directive goes even further than the Public Procurement Directive in its support for SME procurement assistance by tying the support for SMEs to competitiveness and national security goals:

Member States agree on the need to foster, develop and sustain a European Defence Technological and Industrial Base that is capability driven, competent and competitive. In order to achieve this objective, Member States may use different tools, in conformity with Community law, aiming at a truly European defence equipment market and a level playing field at both European and global levels. They should also contribute to the in-depth development of the diversity of the European defense-related supplier base, in particular by supporting the involvement of small and medium-sized enterprises (SMEs) and non-traditional suppliers in the European Defence Technological and Industrial Base, fostering industrial

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53. See Defense Procurement Directive, *supra* note 49, at recital 3 (citing EC, *Commission Interpretive Communication on the Application of the Article 296 of the Treaty in the Field of Defense Procurement*, COM (2006) 779 final (July 12, 2006)); EC, *Strategy for a Stronger and More Competitive European Defence Industry*, at 6, COM (2007) 764 final (May 12, 2007)). Professor Christopher Yukins argues that the Defense Procurement Directive may limit national socioeconomic programs of various European Member States, but may also effectively create a socioeconomic preference in support of European defense firms and strengthen the defense industrial base exclusions of non-European firms from the common European defense market. See Christopher Yukins, *The European Defense Procurement Directive: An American Perspective*, 51 *GOV'T CONTRACTOR* ¶ 383, Nov. 4, 2009, at 6–7. This interpretation is supported by *A Strategy for a Stronger and More Competitive European Defence Industry*, *supra*, at 6 (calling for the need to reduce intra-EU barriers while improving the standing of the EU Defense and Technology Industrial Base as compared to the U.S. industrial base).

54. Public Procurement Directive, *supra* note 48, at recital 2.

55. *Id.* at recital 46.

56. *Id.* arts. 23, 26.

cooperation and promoting efficient and responsive lower tier suppliers. . . . The Commission should carry out a periodic assessment to examine whether the defense equipment market is functioning in an open, transparent and competitive way, including the impact of this Directive on the market, for example on involvement of SMEs.<sup>57</sup>

The EC echoes the same themes in its policies. On June 25, 2008, the EC issued Commission Communication “Think Small First”: A “Small Business Act” for Europe,<sup>58</sup> which provides a set of ten principles to assist SMEs. One of these principles calls on European authorities to “adapt public policy tools to SME needs . . . [to facilitate] SMEs’ participation in public procurement procedures . . . [and] make better use of the possibilities offered by . . . State Aid . . . for SMEs.”<sup>59</sup> As part of this effort, EC Commission Staff published a voluntary European Code of Best Practices Facilitating Access of SMEs to Public Procurement Contracts (“European Code of Best Practices”).<sup>60</sup> The European Code of Best Practices states that “increased involvement of SMEs into public purchasing will result in higher competition for public contracts, leading to better value for money for contracting authorities. In addition to this, more competitive and transparent public procurement practices will allow SMEs to unlock their growth and innovation potential with a positive impact on the European economy.”<sup>61</sup> The European Code of Best Practices lists solutions to assist small businesses with the following issues:

overcoming difficulties relating to the size of the contracts; ensuring access to relevant information; improving quality and understanding of the information provided; settling proportionate qualification levels and financial requirements; alleviating the administrative burden; putting more emphasis on value for money rather than price; giving sufficient time to draw up tenders; and ensuring payments on time.<sup>62</sup>

Similar policies or practices—some described in the European Code—have been adopted by EU Member State governments, EU agencies such as the European Defense Agency (“EDA”), and non-EU organizations such as the European Space Agency (“ESA”).<sup>63</sup> For instance, in the United Kingdom,

57. Defense Procurement Directive, *supra* note 49, at recital 3.

58. EC, “Think Small First”: A “Small Business Act” for Europe, COM (2008) 394 final (June 25, 2008), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0394:FIN:EN:PDF>.

59. *Id.* at 10.

60. *Eur. Code of SME Best Practices*, *supra* note 12, at 5–6.

61. *Id.* at 2.

62. *Id.* at 2–3.

63. See, e.g., BAKER & MCKENZIE, REMEDIES AND PUBLIC PROCUREMENT LAWS IN EUROPE 72 (3d ed. 2009) (citing Gesetz gegen Wettbewerbsbeschränkungen [GWB] [German Act Against Restraints on Competition], 26 August 1998, BUNDESGESETZBLATT, Teil I [BGBl. I] at 2546, § 97(3) (Ger.) (requiring consideration of SME interests in contracts meeting or exceeding EU thresholds through subdivision of contracts into trade and partial lots)); Martin Burgi, *Small and Medium-Sized Enterprises and Procurement Law—European Legal Framework and German Experiences*, 4 PUB. PROCUREMENT L. REV. 284, 289–94 (2007) (discussing SME-friendly and SME-favoring practices such as unbundling of contracts, grouping or teaming of small companies, mandatory SME subcontracting requirements, easier proof of suitability, division of contracts into lots, and limitations of lots per bidder); Andrew Erridge, *Involvement of SMEs in Public*

“[t]he Government’s policy on SMEs is to encourage and support these organisations to compete for public sector contracts where this is consistent with the value for money policy of the UK regulations, EU Treaty principles, and EU procurement directives.”<sup>64</sup> In July 2009, the Irish Department of Enterprise, Trade, and Employment adopted a report on SME procurement assistance stating that “increased involvement of SMEs . . . leads to better value for money.”<sup>65</sup> Procurement policies providing various supports for SMEs either directly or indirectly can be found both in long-term EU Member States, such as the United Kingdom, Germany, France, and Italy, and in new Member States from Central and Eastern Europe, such as Bulgaria or Estonia.<sup>66</sup>

Indeed, support for SMEs appears inherent in procurements conducted by Europe-wide defense and space structures such as the EDA, its predecessor

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*Procurement*, 2 PUB. PROCUREMENT L. REV. 37, 47–49 (1998) (comparing early EU and British small business procurement initiatives with U.S. initiatives); Ioannis Petrou, *The European Space Agency’s Procurement System: A Critical Assessment*, 37 PUB. CONT. L.J. 141, 149–50 (2008) (discussing ESA SME preferences); Pieter Taal, *Depth and Diversity of a Competitive EDTIB: SMEs in Defence*, EUR. DEF. AGENCY (Jan. 13, 2010), [http://ec.europa.eu/enterprise/sectors/defence/files/presentations/stockholm\\_conference/depht\\_and\\_diversity\\_of\\_a\\_competitive\\_edtib\\_en.pdf](http://ec.europa.eu/enterprise/sectors/defence/files/presentations/stockholm_conference/depht_and_diversity_of_a_competitive_edtib_en.pdf) (describing SME procurement assistance measures including SME-focused research programs, assistance with low-value contracts, and subcontracting opportunity requirements). See generally Ciara Kennedy-Loest, *Spreading Contract Work to Ensure Security of Supply and Maintain Competition: The Issues Under the EC Directives*, 2 PUB. PROCUREMENT L. REV. 116, 116 (2007) (arguing that procurement measures favoring SMEs at contract size, teaming, qualification, award, and performance stages are justified because they would carry out the objective of “opening up of public procurement to competition” as stated in the Public Procurement Directive (2004/18/EC)).

64. *Policy on Small and Medium-Sized Enterprises*, U.K. OFF. OF GOV’T COMMERCE, [http://www.ogc.gov.uk/documents/SMEs\(1\).pdf](http://www.ogc.gov.uk/documents/SMEs(1).pdf) (last visited Feb. 28, 2010).

65. PROCUREMENT INNOVATION GRP., DEP’T OF ENTER., TRADE & EMP’T, USING PUBLIC PROCUREMENT TO STIMULATE INNOVATION AND SME ACCESS TO PUBLIC CONTRACTS 16 (2009), available at <http://www.deti.ie/publications/trade/2009/procurementinnovationgroup.pdf>.

66. See, e.g., The Public Contracts Regulations, 2006, S.I. 2006/5, art. 7, ¶ 39 (U.K.), available at [http://www.opsi.gov.uk/si/si2006/uksi\\_20060005\\_en.pdf](http://www.opsi.gov.uk/si/si2006/uksi_20060005_en.pdf) (authorizing the stipulation of conditions relation to the performance of social contracts—potentially including social considerations—to the extent consistent with European Community law); Public Procurement Act, SG 56 1999, arts. 6, 12, 41 (June 9, 1999) (Bulg.), available at [http://www.bcnl.org/doc\\_en.php?DID=316](http://www.bcnl.org/doc_en.php?DID=316) (requiring consideration of SME subcontractor participation in awards of high-value prime contracts and authorizing the Council of Ministers to develop measures ensuring SME participation in low-level contracts); Veiko Lember & Veiko Vaske, *Public Procurement in Post-Transitional Context: The Case of Estonia*, in INTERNATIONAL HANDBOOK OF PUBLIC PROCUREMENT 409, 420 (Kvi V. Thai ed., 2009) (noting that low national thresholds and a procurement model that disfavors consolidated tenders can be deemed to favor SMEs); Mario E. Comba, *Selection and Award Criteria in Italian Public Procurement Law*, 3 PUB. PROCUREMENT L. REV. 122, 124 (2009) (arguing that Italian administrative judges scrutinize contract qualifications requirements so as to protect SMEs from subjective biases of contracting authorities); Laurence Folliot-Lalliot, *The Separation Between the Qualification Phase and the Award Phase in French Procurement Law*, 3 PUB. PROCUREMENT L. REV. 155, 158–59 (2009) (arguing that articles 45, 51, and 52 of the French Public Procurement Code encourage SMEs to rely on qualifications of large businesses as part of bidder teams or groupings); Marcello Thompson Mello Guimarães, *The Northern European Subset: An Open Platform for Cross-Border Procurement*, 4 PUB. PROCUREMENT L. REV. 175, 182, 195 (2008) (arguing that Denmark, Norway, Finland, Sweden, England, and Iceland created an e-procurement project, in part, to assist SMEs with cross-border procurements).

the Western European Armaments Group (“WEAG”), and the ESA. Such support is driven by a comprehensive European industrial base development policy based on the principle of *juste retour* or “fair return,” based on national investment in procurements, and its more recent formulation known as the principle of “mutual benefit.”<sup>67</sup> The principle of fair return resembles national earmarking and “can be described as the equitable industrial return that states require for their domestic industries as a result of the states’ participation to a particular collaborative program. The principle is considered important for countries with small or medium sized defence industries because it secures the involvement of their domestic firms in the defence procurement market.”<sup>68</sup> Its more recent formulation, the principle of mutual benefit, “reflects the idea that in order for the establishment of a European Defense Equipment Market to be meaningful the participation of the largest possible majority of Member States is needed. In particular the aforementioned principle tries to bring on board those Member States which have small and medium-sized defense industries.”<sup>69</sup> Arguably, the latter formulation targets SMEs from all EU countries, signifying a transition in defense industrial policy from the principle of *juste retour* towards support for SMEs.<sup>70</sup> Specifically, the EDA on May 15, 2006, adopted the Code of Best Practices in the Supply Chain (“CoBPSC”) in order to ensure “fair opportunities . . . for small- and medium-size enterprises” and “to promote opportunities, where competition is efficient, practical, and economically or technologically appropriate on a level playing-field basis for qualified and competent suppliers (both in-house and external), including SMEs.”<sup>71</sup> This code is enforced through the reciprocity of Member States. Another foundational EDA policy document, *A Strategy for the European Defense Technological and Industrial Base* (“EDTIB”), states:

We know that our vision of a healthy, competitive and integrated future EDTIB will not be realised if our market-opening efforts are perceived to be simply a bonanza for the large prime contractors. With industry’s active cooperation, we need to drive the benefits of competition down the supply chain—so that excellent second- and third-tier companies, often SMEs (with their typical flexibility and capacity to innovate), are able to prosper in a European scale of market. This makes economic as well as political sense. . . .<sup>72</sup>

67. See Aris Georgopoulos, *The European Defence Agency’s Code of Conduct for Armament Acquisitions: A Case of Paramnesia?*, 2 PUB. PROCUREMENT L. REV. 51, 56 (2006) [hereinafter *EDA Code of Conduct*]; Aris Georgopoulos, *The New European Defence Agency: Major Development or Fig Leaf?*, 2 PUB. PROCUREMENT L. REV. 103, 111 (2005) [hereinafter *The New EDA*]; Petrou, *supra* note 63, at 148.

68. *The New EDA*, *supra* note 67, at 111.

69. *EDA Code of Conduct*, *supra* note 67, at 56.

70. *Id.* at 57; see *The New EDA*, *supra* note 67, at 111.

71. Eur. Def. Agency, *The Code of Best Practice in the Supply Chain*, at 1, 3 (May 15, 2006) [hereinafter *CoBPSC*], available at <http://www.eda.europa.eu/genericitem.aspx?area=organisation&id=159>.

72. Eur. Def. Agency, *A Strategy for the European Defense Technological and Industrial Base*, at 4 (May 14, 2007), available at <http://www.eda.europa.eu/genericitem.aspx?area=Organisation&id=211>.

At the European Space Agency, the policy of assisting SME contractors is even older. “During the March 1997 meeting of the ESA Council, Ministers of ESA Member States called upon the Director General of ESA to reserve a special place for SMEs. The objective is to guarantee them a share in the Agency’s technological activities, and to facilitate their access to technical facilities and tools.”<sup>73</sup> Thus, European SME policies generally address both the issue of opportunity to compete and, to a lesser extent, the issue of share of participation in public procurement through reservation of certain procurement opportunities at the prime contracting and subcontracting levels for SMEs.<sup>74</sup>

### C. Comparison

Both the United States and Europe at the EU and Europe-wide agency level have well-established, comprehensive programs and policies on small business procurement assistance, and such policies are being rapidly implemented among the European Member States. However, the U.S. policies and programs are older and better established than the European ones. While the U.S. assistance measures for small contractors are focused on both the opportunity to participate (such as ensuring a transparent procurement process, providing advance notice of procurement opportunities, simplifying qualifications to bid, or reducing contract sizes) and the actual fair share of participation, the European assistance measures currently in place are focused more on the opportunity to participate. This, however, is changing as European assistance is becoming more focused on measurable, identifiable participation outcomes such as the extent of participation of SMEs in specific contracts.<sup>75</sup> Although Europe historically has not required or encouraged set-asides to the same extent as the United States, European policies and practices effectively include SME participation as an element of best value. In this way, the European approach is similar to the significant evaluation factor approach in U.S. Federal Supply Schedule procurements. This approach creates uncertainty as to whether SME participation will, at the end, carry the day and drive the award of a specific contract. The European approach of requiring SME participation as a contract performance condition also introduces uncertainty, as such participation requirement can vary contract-by-contract. Both these approaches also convey the appearance of a procurement system free of SME preferences, when this is not the case. Nonetheless, assuming EU states will be following the EC directives on public and defense procurement, it is likely that civilian and defense projects will be steered to European SMEs on an even greater scale.

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73. *Definition of Small and Medium Sized Enterprises*, EUR. SPACE AGENCY, [http://www.esa.int/SPECIALS/SME/SEMQKI0CYTE\\_0.html](http://www.esa.int/SPECIALS/SME/SEMQKI0CYTE_0.html) (last visited Aug. 19, 2009).

74. *Id.*

75. See Defense Procurement Directive, *supra* note 49, art. 21(4); Public Procurement Directive, *supra* note 48, art. 32; *A Strategy for the European Defence Technological and Industrial Base*, *supra* note 72.

### III. DEFINING SMALL BUSINESS ENTERPRISES

One clear and obvious indication of targeted policies to assist small businesses in government contracting is an official, legally binding definition of a small business for government procurement purposes. Both European and U.S. authorities have adopted such definitions. These definitions include criteria that are specific to certain jurisdictions, contracts, or agencies, as well as criteria that are generally applicable to the procurement system at large.

#### A. *The U.S. Approach: An Industry-Sensitive Definition Framework*

The United States traditionally has eschewed a one-size-fits-all approach to defining what would be a small business for purposes of government contracting. Instead, the United States has generally taken into account industry-specific trends and conditions. In the Small Business Act, Congress provided that “a small business concern . . . shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation.”<sup>76</sup> Further, Congress gave the SBA the authority to specify, “in addition to the[se] criteria, detailed definitions or standards by which a business concern may be determined to be a small business concern for the purposes [of the Small Business Act] or any other Act.”<sup>77</sup> The SBA’s criteria “may utilize number of employees, dollar volume of business, net worth, a combination thereof, or other appropriate factors,” but the SBA “shall ensure that the size standard varies from industry to industry to the extent necessary to reflect differing characteristics of the various industries and consider other factors determined to be relevant by the [SBA] Administrator.”<sup>78</sup> The Small Business Act makes it “the duty” of the SBA “to determine within any industry the concerns, firms, persons, corporations, partnerships, cooperatives, or other business enterprises which are to be designated ‘small-business concerns’” and requires the SBA Administrator to issue upon request a revocable certificate that a concern is a small business.<sup>79</sup> Congress has generally refrained from

76. 15 U.S.C. § 632 (2006).

77. *Id.*

78. *Id.* Ralph Thomas, the former NASA Assistant Administrator for Small and Disadvantaged Business Utilization, provides a general description of the SBA’s size standards methodology:

Generally, the size status for manufacturing industries is employee-based in that a company’s size is determined by calculating the average employment of the company, including the employees of its domestic and foreign affiliates, based on the number of persons employed on a full-time, part-time, temporary, or other basis, during each of the pay periods of the preceding 12 months. For service and construction companies, the SBA, for the most part, uses a receipts-based standard whereby it determines size by averaging a firm’s annual receipts, including the receipts of its domestic and foreign affiliates (less returns and allowances, sales of fixed assets, and inter-affiliate transactions) for the previous three years.

Ralph C. Thomas III, *Playing by the Numbers: Recalculating How Many Employees Equal a Small Business*, CONT. MGMT., Feb. 2009, at 43, available at <http://www.ncmahq.org/files/articles/CM0209%20-%20p42-49.pdf>.

79. 15 U.S.C. § 637(b)(6). This process is rarely used, as most small firms self-certify their size.

establishing specific size standards by statute.<sup>80</sup> The SBA has promulgated Small Business Size Regulations pursuant to this authority at 13 C.F.R. Part 121.

In the United States, size standards for government procurement purposes have changed over the years. According to the late U.S. Senator Leverett Saltonstall, a member of congressional leadership in the 1950s,<sup>81</sup> Congress originally passed a small business definition for defense procurement purposes in the Selective Service Act of 1940, imposing a size cap of “500 employees, including affiliated.”<sup>82</sup> Congress, however, has frequently criticized the SBA’s 500-person size cap applicable to all federal contracts as too inflexible and unresponsive to the realities of the marketplace.<sup>83</sup>

Since 1997, the SBA has relied on the North American Industrial Classification System (“NAICS”) to determine the type of industry in which a company is participating. NAICS was developed to facilitate better comparisons among industries of the United States, Canada, and Mexico. According to the SBA’s Guide to Size Standards, the SBA “has established two widely used size standards: 500-employees for most manufacturing and mining industries and \$7.0 million in average annual receipts for most nonmanufacturing industries. However, many exceptions exist.”<sup>84</sup> Size standards generally apply to procurement as well as nonprocurement assistance. Common industry-specific size standards include size standards ranging from \$7 million to \$20 million in average annual receipts for various industries related to construction and dredging; size standards capped at 750, 1,000, or 1,500 employees for certain manufacturing industries not subject to the 500-employee size standard; a 500-employee size standard for nonservice mining industries; size standards ranging from \$7 million to \$29 million in average annual receipts for retail industries; size standards ranging from \$7 million to \$35.5 million in average annual receipts for most service industries; a 500-employee size standard and a generally applicable requirement for wholesale trade industries that

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80. *Contra id.* § 632(a) (setting forth a \$750,000 annual receipts cap for agricultural enterprises, including affiliates).

81. Leverett Saltonstall, U.S. Senator, Lecture on Small Business and National Security (Jan. 25, 1957), in *INDUS. COLL. OF THE ARMED FORCES PUB. NO. L57-102*, at ii, available at <http://digitalndulibrary.ndu.edu/cdm4/document.php?CISOROOT=icafarchive&CISOPTR=28353&REC=4>.

82. *Id.* at 2 (referring to the industrial mobilization provisions in section 9 of the Selective Training and Service Act of 1940, ch. 720, 54 Stat. 885 (codified as amended at 50 U.S.C. app. § 309 (1946))).

83. See generally *SBA’s Efforts to Streamline Size Standards: Hearing Before the Subcomm. on Minority Enter., Fin., & Urban Dev. of the H. Comm. on Small Bus.*, 103d Cong. (1994), available at [http://ia311024.us.archive.org/1/items/sbaseffortstotr00unit/sbaseffortstotr00unit\\_bw.pdf](http://ia311024.us.archive.org/1/items/sbaseffortstotr00unit/sbaseffortstotr00unit_bw.pdf). Recently, Congress again increased pressure on the SBA’s rulemaking in this area by requiring periodic eighteen-month reviews of not less than one-third of all size standards and by imposing heightened transparency, disclosure, and public participation standards. See *Small Business Jobs Act of 2010*, Pub. L. No. 111-240, § 1344, 124 Stat. 2504, 2542 (to be codified at 15 U.S.C. § 637(d)).

84. U.S. SMALL BUS. ADMIN., *GUIDE TO SIZE STANDARDS 5* (2009), available at [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/guide\\_to\\_size\\_standards.pdf](http://www.sba.gov/idc/groups/public/documents/sba_homepage/guide_to_size_standards.pdf).

do function in the financial sector that items supplied be a product of a U.S. small domestic manufacturer.<sup>85</sup> Other industries such as finance, insurance, transportation, and electricity have size standards with “no common pattern” for industry groups.<sup>86</sup> In addition, a few industries have additional regulatory conditions for purposes of government procurement programs, such as the 125,000 barrels per calendar day total operable atmospheric crude oil distillation capacity for petroleum refineries.<sup>87</sup> For purposes of pro-innovation set-aside competitions under the Small Business Innovation Research Program (“SBIR”) and the Small Business Technology Transfer Program, the size standard is 500 employees regardless of the industry in which the research and development (“R&D”) work is to be conducted.<sup>88</sup> For purposes of the Very Small Business (“VSB”) Set-Aside Pilot Program in existence between 1994 and 2003, the size standard was fifteen employees or less and average annual revenues of \$1 million or less.<sup>89</sup> Detailed size standards are published in the SBA’s regulations and its Table of Small Business Size Standards; they have the force and effect of law.<sup>90</sup> To accommodate the diversity of industries and programs, size standards have become rather complex: the SBA Table goes on for twenty-five pages setting forth size standards in well over a thousand industry categories,<sup>91</sup> while the SBA’s Guide to Size Standards goes on for another seventeen pages.<sup>92</sup>

A business concern may be small in one industry category and yet large in another. Under SBA regulations, Contracting Officers are responsible for choosing the NAICS code that best describes the “principal purpose” of the product or service acquired.<sup>93</sup> The basis for this decision is subject to a complex six-factor test, which includes (1) “industry descriptions” in the NAICS Manual, (2) description of the product or service in solicitation documents, (3) “value and importance” of the procurement’s components, (4) functions of products and services procured, (5) prior procurement classifications in similar purchases, and (6) the purposes of the Small Business Act.<sup>94</sup> A procurement is usually classified according to the component that accounts for the greatest percentage of contract value. Despite their complexity, the U.S. small business size definitions are publicly available and generally applicable to contracts and subcontracts across federal agencies.

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85. *Id.* at 5–6.

86. *Id.* at 6.

87. *See id.*

88. *See* 13 C.F.R. § 121.702 (2010).

89. *See* FAR 19.9, 52.219-5 (2003) (providing for set-asides of small contracts for very small businesses within certain geographic areas).

90. *See* 13 C.F.R. § 121.201; FAR 19.102 (2007).

91. *See generally* 13 C.F.R. § 121.201.

92. GUIDE TO SIZE STANDARDS, *supra* note 84.

93. 13 C.F.R. § 121.402(b); FAR 19.102 (2007).

94. 13 C.F.R. § 121.402(b).

SBA's employee-based caps are calculated prior to each representation or certification of small business size based on the average number of employees for each pay period "over the preceding 12 months."<sup>95</sup> Part-time or temporary employees count the same as full-time employees.<sup>96</sup> Total average employees of all entities considered affiliated with the enterprise that have been employed by those affiliates over the preceding twelve-month period (even if affiliation arose more recently) are included in the count.<sup>97</sup> There is no official definition of a "medium-sized business" in the United States for procurement purposes.<sup>98</sup>

In addition to assuring predictability and transparency in small business definitions, Congress and the SBA have established a panoply of safeguards to protect the U.S. small business size definitions from fraud and manipulation. These safeguards include not only publicly available and legally binding definitions, but also the process to appeal the NAICS designations for individual contracts;<sup>99</sup> the process to protest to the SBA a company's representation that it is a small business;<sup>100</sup> the regulations concerning affiliation with large businesses and ostensible subcontracting with large businesses;<sup>101</sup> regulations concerning recertification of a former small business that became too large through growth, mergers, or acquisitions;<sup>102</sup> prohibition on subcon-

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95. *Id.* § 121.106.

96. *Id.*

97. *Id.*

98. *Cf.* 15 C.F.R. § 296.2 (providing that a medium-sized business in the U.S. Department of Commerce Technology Innovation Program (TIP) is one "that does not qualify as a small-sized business or a large-sized business" with large business defined in part by the "dollar value of the total revenues of the 1000th company in Fortune magazine's Fortune 1000 listing").

99. 13 C.F.R. § 121.1101–.1102.

100. *See id.* § 121.1001–.1101.

101. *See id.* § 121.103. The "ostensible subcontractor rule" was recently described by the SBA Office of Hearings and Appeals in Analysis Grp., LLC, SBA No. SIZ-2006-09-12-52 (Oct. 17, 2006), available at <http://www.sba.gov/aboutsba/sbaprograms/oha/allcases/sizcases/SIZ-4814.pdf>. The appeal stated the following:

The ostensible subcontractor rule is an independent basis for finding affiliation between two concerns. 13 C.F.R. § 121.103(h)(4). The purpose of the rule is to prevent other than small firms from forming relationships with small firms to evade SBA's size requirements. The ostensible subcontractor rule permits the Area Office to determine a subcontractor and a prime have formed a joint venture (and are thus affiliates) for determining size. An ostensible subcontractor is a subcontractor that performs primary and vital requirements of a contract or a subcontractor upon which the prime contractor is unusually reliant. 13 C.F.R. § 121.103(h)(4). In determining whether a subcontractor performs primary and vital requirements or that the prime is unusually reliant, the Area Office must consider all aspects of the prime-subcontractor relationship including, but not limited to, the terms of the proposal, agreements between the prime and the subcontractor (such as teaming agreements), and whether the subcontractor is an incumbent contractor and is ineligible to submit a proposal because it exceeds the size requirements for the solicitation.

*Id.*

102. Small Business Size Regulations, 71 Fed. Reg. 66,434 (Nov. 15, 2006) (to be codified at 13 C.F.R. pts. 121, 124). Under section 1342 of the Small Business Jobs Act of 2010, concerns claiming small business size or status will have to certify and recertify annually in the Online Representations and Certifications Application or any successor database. Pub. L. No. 111-240,

tracting the majority of the work on small business set-asides to large businesses, known as “limitations on subcontracting”;<sup>103</sup> and criminal and civil penalties for misrepresentation of small business size.<sup>104</sup> Individual federal agencies generally cannot, on their own, adjust small business size or status requirements or safeguards such as the limitation on subcontracting for individual contracts.<sup>105</sup>

Perhaps the most important policy safeguards against manipulation of small business definitions in the U.S. procurement system are the SBA’s rules limiting affiliation of small business concerns with other businesses. In particular, the SBA affiliation regulations at 13 C.F.R. § 121.103 provide that “concerns and entities are affiliates of the other when one controls or has the power to control the other, or a third party or parties controls or has [sic] the power to control both. It does not matter whether control is exercised, as long as the power to control exists.”<sup>106</sup> Affiliation is determined based on totality-of-the-circumstances basis; relevant factors include not only ownership, but also management, prior relationships, indirect ties through third parties, and contractual relationships.<sup>107</sup> Affiliation also may be found based on negative control, which includes “instances where a minority shareholder has the ability, under the concern’s charter, bylaws, or shareholder’s [sic] agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.”<sup>108</sup> Affiliation may be found even where “no single factor” by itself would create affiliation.<sup>109</sup> Thus, affiliation restrictions are intentionally broad in order to serve as catchall for schemes to manipulate small business programs.

### B. *The European Approach: A User-Friendly Definition Framework*

European nations have had a variety of SME size standards or definitions. However, within the EU framework, the European Commission is

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§ 1342, 124 Stat. 5204, 5244 (to be codified at 15 U.S.C. § 632). Section 1342 is intended to override current SBA size regulations, which allow concerns that outgrow size caps to continue claiming small business status up to five years on long-term contracts.

103. See 15 U.S.C. § 644(o) (2006); FAR 52.219-14.

104. 15 U.S.C. § 645(d). Sweeping new penalties were recently enacted in sections 1341 and 1343 of the Small Business Jobs Act of 2010. Pub. L. No. 111-240, §§ 1341, 1343 (to be codified at 15 U.S.C. § 632). By its terms, section 1341 applies to set-aside and non-set-aside awards alike. Specifically, section 1341 establishes “a presumption of loss to the United States based on the total amount expended” on a contract, subcontract, or other type of award whenever such award is “willfully sought and received by misrepresentation.” Section 1341 also requires size or status certifications by authorized corporate officials, and provides that certain statements, registrations, representations, or statements in bids, proposals, or federal databases “shall be deemed affirmative, willful, and intentional certifications of small business size and status.” Section 1343 requires a federal policy on small business procurement fraud prosecutions.

105. See, e.g., *Centech Grp. v. United States*, 555 F.3d 1029, 1039 (Fed. Cir. 2009) (citing *United States v. Amdahl Corp.*, 786 F.2d 387, 392–93 (Fed. Cir. 1986)).

106. 13 C.F.R. § 121.103 (2010).

107. *Id.*

108. *Id.*

109. *Id.*

responsible for promulgating a definition applicable to EU activities. The Commission's definitions of SMEs are not legally binding on Member States.<sup>110</sup> Prior to 1996, the EU SME definition corresponded to the traditional U.S. size standard cap of 500 employees.<sup>111</sup> However, since 1996, the Commission has adopted two recommendations concerning SME definitions: Commission Recommendation 96/280/EC of April 3, 1996, and Commission Recommendation 2003/361/EC of May 6, 2003, which became effective on January 1, 2005.<sup>112</sup> The latest definition applies to EU agencies and programs, such as the EDA, and EU Members States are invited to use it.<sup>113</sup> ESA also follows this definition.<sup>114</sup> The EU definitions also are used in the European Economic Area ("EEA"), for example, in Switzerland.<sup>115</sup>

The 2003 EC Recommendation establishes "staff headcounts and financial ceilings" to determine what constitutes a "micro, small and medium sized enterprise."<sup>116</sup> SMEs are "made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million."<sup>117</sup> Small enterprises are those that employ less than fifty persons, with an annual turnover and/or balance sheet not exceeding €10 million.<sup>118</sup> Microenterprises are those that employ less than ten people, with an annual turnover and/or balance sheet total not exceeding €2 million.<sup>119</sup> According to the European Central Bank's 2009 data, this represents dollar-based ceilings worth approximately \$71 million in annual turnover and/or an annual balance sheet worth approximately \$61 million for SMEs, \$14 million for small enterprises, and \$3 million for microenterprises.<sup>120</sup> According to the *New SME Definition User Guide*,

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110. EC, *The New SME Definition: User Guide and Model Declaration*, at 6 (Mar. 9, 2005) [hereinafter *EC New SME Definition Guide*], available at [http://ec.europa.eu/enterprise/policies/sme/files/sme\\_definition/sme\\_user\\_guide\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf).

111. *See id.*

112. Commission Recommendation Concerning the Definition of Micro, Small and Medium-sized Enterprises (EC) No. 96/280 of 30 Apr. 1996, 1996 O.J. (L 107) 4; Commission Recommendation Concerning the Definition of Micro, Small and Medium-sized Enterprises (EC) No. 2003/361 of 6 May 2003, 2003 O.J. (L 124) 36.

113. *See EC New SME Definition Guide*, *supra* note 110, at 6; Eur. Def. Agency, *Standard Questionnaire to Defence Suppliers on the Application of the Code of Best Practice in the Supply Chain (CoBPSC)*, at 1-2 (Apr. 12, 2007), available at <http://www.eda.europa.eu/genericitem.aspx?area=30&id=298>.

114. *See* Eur. Space Agency, *Definition of Small & Medium Sized Enterprises*, at 1 (Jan. 26, 2005), available at [http://www.esa.int/SPECIALS/Resources/SEMB8SHAATME\\_0.html](http://www.esa.int/SPECIALS/Resources/SEMB8SHAATME_0.html).

115. Fed. Dep't of Econ. Affairs, Swiss Confed'n, Switzerland's SME Policy 5 (May 2009).

116. Commission Recommendation 2003/361, *supra* note 112, art. 1 (concerning the definition of small and medium-sized enterprises).

117. *Id.* art. 2.

118. *Id.*

119. *Id.*

120. *See Euro Foreign Exchange Reference Rates*, EUR. CENT. BANK (Aug. 27, 2009), <http://www.ecb.int/stats/exchange/eurofxref/html/index.en.html> (establishing rate of \$1.4268 per euro on Aug. 27, 2009).

“annual turnover is determined by calculating the income that your enterprise received during the year in question for sales and services after all rebates have been paid out,” not including value-added and other indirect taxes, while “the annual balance sheet refers to the value of your company’s assets.”<sup>121</sup> Employees are calculated in “annual work units” (“AWUs”), a concept that parallels the American concept of full-time equivalents (“FTEs”).<sup>122</sup> As a result, part-time and seasonal workers are included in the calculation as parts of AWUs. However, time spent on paternity or maternity leave is not counted. Employees, active partners, managing owners, and employees of subordinate enterprises who are considered employees under national laws of EU Member States also are included in the AWU calculation. On the other hand, apprentices or vocational training students are not included in the count.<sup>123</sup>

It is important to note that not all EU Member States follow the EC definition. For instance, the United Kingdom, a country with a large and well-established procurement system, currently appears to target its procurement assistance “for small and medium-sized enterprises . . . with up to 500 employees.”<sup>124</sup>

The 2003 EU definition contains several protections against manipulation and circumvention by large businesses. However, in comparison to the 1996 EU definition, these protections have been relaxed in order to enable companies to attract outside financing.<sup>125</sup> Anti-manipulation and anti-circumvention measures under the 2003 definition include rules governing affiliation with SMEs of other business entities, natural persons, universities, venture capitalists and business angels, and even government authorities. The affiliation rules draw a distinction between three types of SMEs: autonomous, partner, and linked enterprises.

Separately, the European Code of Best Practices encourages SMEs to invoke article 47(2) of the Public Procurement Directive, which authorizes contractors “where appropriate and for a particular contract, [to] rely on the capacities of other entities, regardless of the legal nature of the links it has with them.”<sup>126</sup> This policy could be viewed as authorizing ostensible subcontractor-type arrangements with large businesses.

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121. *EC New SME Definition Guide*, *supra* note 110, at 15 (citing Council Directive 78/660, art. 28, 1978 O.J. (L 222) 11, 11–14 (EC)).

122. *See, e.g.*, 13 C.F.R. § 126.103 (2009) (“Full-time equivalent includes employees who work 30 hours per week or more. Full-time equivalent also includes the aggregate of employees who work less than 30 hours a week, where the work hours of such employees add up to at least a 40 hour work week.”).

123. *EC New SME Definition Guide*, *supra* note 110, at 15.

124. *Procurement*, U.K. DEP’T FOR BUS. INNOVATION & SKILLS, <http://www.berr.gov.uk/about/procurement> (last visited Sept. 6, 2009).

125. *Compare* Commission Recommendation 96/280, *supra* note 112, *with* Commission Recommendation 2003/361, *supra* note 112.

126. Public Procurement Directive, *supra* note 48, art. 47(2).

Further, the apparent clarity and predictability of the EU definition is obviated by the absence of a mandatory size enforcement process and by the language granting safe harbor to companies declaring themselves SMEs “even if the capital is spread in such a way that it is not possible to determine by whom it is held.”<sup>127</sup> The EC permits such a company to “declare in good faith that it can legitimately presume that it is not owned as to 25% or more by one enterprise or jointly by enterprises linked to another.”<sup>128</sup> Such declarations, however, may be challenged in the course of “check and investigations” under separate EU or Member State laws or rules.<sup>129</sup>

### C. Comparison

In terms of public policy objectives, Europe appears to emphasize user-friendliness, clarity, and simplicity in its SME definitions. This is particularly true with regards to concerns related to affiliation with other entities: a European contracting official or SME owner, by consulting *The New SME Definition Guide*,<sup>130</sup> could easily determine whether or not an enterprise in question is a large business by affiliation. This is a substantial advantage in the administration of small business assistance measures. However, it would be hard to argue that this one-size-fits-all approach is a genuine reflection of conditions in the industries in which small firms have to compete. Accordingly, SME-specific assistance in Europe could simultaneously be denied to deserving firms in some industries and extended to firms that would be considered large under an industry-specific analysis in other industries. On the other hand, the complexity of the U.S. small business size standards is somewhat of a necessary evil because it reflects considerations of industry-specific conditions and fair competition among similarly situated firms in the same industries.

In terms of the absolute measures of size, the competitive impact of assistance based on these definitions is hard to estimate across the board. For example, the United Kingdom apparently still uses the 500-employee definition in some circumstances,<sup>131</sup> equivalent to the traditional American standard. The EU has larger size caps across all industries in general, while the United States has larger overall size caps in some of its industries. Thus, although competitive impact will be determined on an industry-by-industry basis, U.S. services firms would be generally disadvantaged by the EU SME definition while U.S. manufacturers should be favored by it.

Moreover, the European definition favors jobs creation more than the U.S. definition. This is because the underlying mathematics used in calculating

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127. Commission Recommendation 2003/361, *supra* note 112, art. 3, § 5.

128. *Id.*

129. *Id.*

130. *EC New SME Definition Guide*, *supra* note 110.

131. See U.K. DEP'T FOR BUS. INNOVATION & SKILLS, *supra* note 124.

employee-based size caps is not the same across the Atlantic. One AWU/FTE-based European employee can equal several U.S. employees based on counting rules in the SBA regulations.<sup>132</sup> As a result, a U.S. R&D or manufacturing firm with 100 full-time employees and another 600 employees working only a quarter of an FTE each would be the economic equivalent of a European enterprise employing 250 AWU employees. As a matter of SBA regulations, such U.S. firms would bust even the supposedly higher 500-employee U.S. size standards for R&D or manufacturers by 200 employees, would be branded as large businesses, and would be denied procurement assistance or preferences under the Small Business Act.<sup>133</sup> The U.S. firm appears to be a giant almost three times larger than the European firm, but this appearance is false. In reality, the two firms have the same size as measured by full-time employment. Had such U.S. firm relocated to Europe, it would still have qualified for SME-specific procurement measures. By using the AWU/FTE method, Europeans enable their SMEs to create more jobs than U.S. firms before the European SMEs are forced to compete as large businesses.

The supposed advantages for U.S. small businesses in industries with relatively high size standards lose their luster even more once the U.S. and the EU definitions for protections against manipulation and fraud are considered. In comparison with the U.S. small business size standard system, the European definition does not sufficiently protect independence of ownership or operation of SMEs, and is highly vulnerable to fraud and manipulation by large businesses or investor government agencies. First, the European affiliation and anti-circumvention rules plainly allow companies that are majority-owned by large businesses and government agencies to qualify as autonomous SMEs as long as each such investor owned less than twenty-five percent.<sup>134</sup> Indeed, based on examples throughout *The New SME Definition Guide*,<sup>135</sup> an SME would be considered merely partnered if a large business owned just under fifty percent and two other large businesses owned between twenty and twenty-five percent each. Second, negative control affiliation is not recognized under the EU definition; instead, the EU definition contains what appears to be a legal presumption that minority shareholders do not control an SME.<sup>136</sup> These policies further tilt the competitive field towards Europe over the United States by opening the doors to large business manipulation of European SME procurement assistance measures. Third, the European affiliation rules for partner enterprises exclude the majority of their employees

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132. Compare *EC New SME Definition Guide*, *supra* note 110, at 15 (excluding workers on paternity or maternity leave and apprentices or vocational training students from definition of "employee"), with 13 C.F.R. § 121.106 (2010) (counting part-time or temporary employees as full-time employees).

133. See 15 U.S.C. § 632 (2006); *GUIDE TO SIZE STANDARDS*, *supra* note 84, at 5.

134. See Commission Recommendation 2003/361, *supra* note 112, art. 3, § 4.

135. *EC New SME Definition Guide*, *supra* note 110.

136. *Id.*

from the count of the enterprise claiming SME status.<sup>137</sup> The integrity of the definition is stronger in the United States, where SBA affiliation rules require adding all employees of all affiliated firms.<sup>138</sup> Fourth, the EC imposes no requirements that an SME perform the majority of the work on a public contract or subcontract, or provide supplies manufactured by an SME. In addition, the EC does not require a formal size protest mechanism, companies may declare their SME status claiming “in good faith” lack of knowledge of their own ownership, and the 2003 EC Recommendation says nothing about whether the European authorities would aggressively pursue criminal or civil fraud enforcement of SME size fraud.<sup>139</sup>

Thus, from the U.S. perspective, there is a real risk that European programs for SMEs, such as R&D set-asides, will operate as mere domestic preferences for European firms, regardless of size.

#### IV. CREATION OF SMALL BUSINESS PROCUREMENT ASSISTANCE AGENCIES

To assist small firms with accessing public procurement markets, both European and U.S. authorities created specialized government institutions. These institutions not only provide financing and technical assistance counseling to the private sector, but they also engage their sister agencies in efforts to expand procurement opportunities to small firms. However, these institutions appear to be more independent in the United States.

##### A. *The U.S. Approach: An Independent, Central Small Business Advocate and Regulator*

An independent federal agency with presidentially appointed, Senate-confirmed administrator and deputy administrator, the SBA “shall be under the general direction and supervision of the President and shall not be affiliated with or be within any other agency or department of the Federal Government.”<sup>140</sup> To further enhance the SBA’s independent voice with regards to complaints of small businesses, regulatory relief, and studies of small business programs (including government contracting programs), Congress created within the SBA a special Office of Advocacy led by the presidentially appointed, Senate-confirmed chief counsel for advocacy.<sup>141</sup> Nonetheless, the SBA has been endowed with powers not only to engage in cooperative inter-governmental efforts,<sup>142</sup> but also to promulgate regulations binding on private

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137. See Commission Recommendation 2003/361, *supra* note 112, art. 3.

138. 13 C.F.R. § 121.106 (2010).

139. See generally Commission Recommendation 2003/361, *supra* note 112.

140. 15 U.S.C. § 633(a) (2006).

141. *Id.* §§ 634a–634g.

142. See *id.* § 631a(a).

individuals and other agencies.<sup>143</sup> The SBA has issued numerous regulations concerning small business contracting and subcontracting.<sup>144</sup>

In addition, the SBA has been directed by the Small Business Act<sup>145</sup> to designate Procurement Center Representatives (“PCRs”) (as well as Breakout Procurement Center Representatives (“BPCRs”) and other personnel) for oversight of major buying activities of the Government, including

reviewing proposed acquisitions and recommending alternative procurement strategies; identifying qualified small business sources; reviewing subcontracting plans; conducting reviews of the contracting office to ensure compliance with small business policies; counseling small businesses; and sponsoring and participating in conferences and training designed to increase small business opportunities.<sup>146</sup>

To emphasize the importance of advocacy for small business within government agencies, the Small Business Act also directed that each federal agency with contracting authority must establish the Office of Small and Disadvantaged Business Utilization (“OSDBU”), with the director reporting to the head of the agency.<sup>147</sup> OSDBUs are “responsible for ensuring that small businesses have the maximum practicable opportunity to participate in the performance of federal contracts as both prime contractors and subcontractors.”<sup>148</sup> OSDBU offices are required by law to closely work with the SBA.<sup>149</sup> Various agency-specific authorities generally enhance the policies of the Small Business Act.

Finally, small business procurement initiatives are promoted and supported through the White House Office of Federal Procurement Policy (“OFPP”). The OFPP is charged by its authorizing statute with developing policies that would help federal agencies achieve their small business goals and would ensure “maximum practicable opportunities” for small business participation in small-dollar procurements.<sup>150</sup>

### B. *The European Approach: Centralized Advocacy, Varied National Implementation*

European efforts to create public authorities specifically charged with directing various forms of procurement assistance have been relatively

143. *See id.* § 634.

144. These are generally found in title 13, chapters 101, 115, 121, 124, 125, 126, and 127 of the Code of Federal Regulations.

145. 15 U.S.C. § 644.

146. OFFICE OF FED. PROCUREMENT POLICY, OFFICE OF MGMT. & BUDGET, CONTRACT BUNDLING: A STRATEGY FOR INCREASING FEDERAL CONTRACTING OPPORTUNITIES FOR SMALL BUSINESS 7 (2002) [hereinafter CONTRACT BUNDLING REPORT], available at [http://www.whitehouse.gov/sites/default/files/omb/assets/procurement/contract\\_bundling\\_oct2002.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/procurement/contract_bundling_oct2002.pdf).

147. *Id.* The reporting chain is different for the Department of Defense.

148. *Id.*

149. *See* 15 U.S.C. § 644(k).

150. *See* Office of Federal Procurement Policy Act of 1974, 41 U.S.C. § 405 (2006). The Small Business Act also charges OFPP with responsibilities for attaining small business goals. *See* 15 U.S.C. § 644(g)(1).

recent—but they are at least as comprehensive as similar efforts in America, if not more. In Europe, small business procurement policies are developed and implemented at three different levels: the European Union level; the level of non-EU European agencies or institutions; and the level of individual EU members, including both national and subnational authorities.<sup>151</sup> At the EU level, small business procurement policy is handled by the European Commission, including its Enterprise & Industry (“EI”) Directorate-General, the EDA, and the Community Research & Development Information Service (“CORDIS”).<sup>152</sup> The EI Directorate-General is responsible for initiatives to support the growth and development of SMEs. Its comprehensive efforts for small business procurement began with the *Green Paper, Public Procurement in the European Union: Exploring the Way Forward*, published on November 27, 1996.<sup>153</sup> Following the paper’s publication, the EC took official action on small business procurement by issuing Commission Communication COM (98) 143 final, *Public Procurement in the European Union*, on March 11, 1998.<sup>154</sup> However, the European-level activities to promote small business procurement have been historically limited to promoting regulatory simplification and fairness in cross-border trade.<sup>155</sup>

To enhance SME participation in policymaking at the EU level, the EC created a special position of SME Envoy with the rank of the Deputy Director-General of the EC Directorate-General of Enterprise and Industry. The SME Envoy promotes the “Think Small First” strategies for public procurement, state aid to enterprises, and R&D activities (embodied in a guidebook by the same title) in activities of EU and Member State agencies.<sup>156</sup>

European agencies and institutions that are, strictly speaking, not part of the EU structure also have created or adopted procurement policies in support of SMEs. One example is the ESA, which is an international organization dedicated “to the development of Europe’s space capability”<sup>157</sup> as well as to “political efforts to forge a united Europe”<sup>158</sup> and to “building Europe as a po-

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151. See *EC New SME Definition Guide*, *supra* note 110, at 5–9.

152. See generally EC, *Doing Business with the European Commission* (2009), available at [http://ec.europa.eu/budget/library/publications/public\\_contracts/doing\\_business\\_en.pdf](http://ec.europa.eu/budget/library/publications/public_contracts/doing_business_en.pdf).

153. See generally EC, *Green Paper on Public Procurement in the European Union: Exploring the Way Forward* (Nov. 27, 1996), available at [http://europa.eu/documents/comm/green\\_papers/pdf/com-96-583\\_en.pdf](http://europa.eu/documents/comm/green_papers/pdf/com-96-583_en.pdf).

154. EC, *Commission Communication on Public Procurement in the European Union*, COM (1998) 143 final (Mar. 11, 1998), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:1998:0143:FIN:EN:PDF>.

155. See *The European Charter for Small Enterprises*, *supra* note 38.

156. *SME Envoy*, EC, [http://ec.europa.eu/enterprise/entrepreneurship/sme\\_envoy.htm](http://ec.europa.eu/enterprise/entrepreneurship/sme_envoy.htm) (last visited Sept. 6, 2009).

157. *What Is ESA?*, EUR. SPACE AGENCY, [http://www.esa.int/SPECIALS/About\\_ESA/SEMw16ARR1F\\_0.html](http://www.esa.int/SPECIALS/About_ESA/SEMw16ARR1F_0.html) (last visited Aug. 23, 2009).

158. Petrou, *supra* note 63, at 143 n.7 (quoting Stacia E. Zabusky, *Ethnography in/of Transnational Processes: Following Gyres in the Worlds of Big Science and European Integration*, in *ETHNOGRAPHY IN UNSTABLE PLACES: EVERYDAY LIVES IN CONTEXTS OF DRAMATIC POLITICAL CHANGE* 113, 123, 144 n.8 (Carol J. Greenhouse et al. eds., 2002)).

litical entity.”<sup>159</sup> The ESA’s ruling Council includes eighteen Member States: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom; Canada participates in some projects under a Cooperation Agreement.<sup>160</sup> Estonia, Hungary, Poland, Romania, and Slovenia participate in ESA activities under a special agreement for European countries.<sup>161</sup> The ESA created an SME Policy Office that “manages and coordinates, ESA-wide, application of the SME Policy” and “put in place a number of measures to reinforce the technical capabilities and sustainability of high technology SMEs in order to facilitate their involvement in ESA activities” such as set-asides and subcontracting clauses.<sup>162</sup>

The European Free Trade Association (“EFTA”) undertook a somewhat different approach. There, the relatively generalist EFTA Surveillance Authority monitors SME-specific assistance measures.<sup>163</sup> A similar approach—assigning SME responsibilities to a generalist organization—is undertaken by the European Defense Agency. SME assistance is the focus of the Industry and Market Directorate as part of its responsibilities for enhancement of the European defense industrial base.<sup>164</sup>

In light of both the EU’s traditionally limited involvement in small business procurement and the EU’s recent drive to increase such involvement, EU nations and their subnational units created their own individual small business procurement authorities. For instance, procurement-related assistance to SMEs in the United Kingdom is a responsibility of both the Small Business Service (“SBS”) within the Department of Trade and Industry (currently the Department of Business, Innovation, and Skills), and its Office of Government Commerce (“OGC”) within the Department of the Treasury.<sup>165</sup> The mission of the SBS, created in 2000, is to facilitate business start-ups and development, while the OGC strives “to achieve effective competition for government business by simplifying access to the government market place.”<sup>166</sup>

### C. Comparison

Formal offices or agencies responsible for small business procurement assistance have been widely established in the United States and in Europe.

159. *Id.* at 144 n.8 (quoting remarks by former Chancellor of the Federal Republic of Germany Helmut Kohl).

160. *New Member States*, EUR. SPACE AGENCY, [http://www.esa.int/esaMI/About\\_ESA/SEMP936LARE\\_0.html](http://www.esa.int/esaMI/About_ESA/SEMP936LARE_0.html) (last visited Oct. 3, 2010).

161. *Id.*

162. *SME Policy Office*, EUR. SPACE AGENCY, [http://www.esa.int/SPECIALS/SME/SEMZSY7QQE\\_0.html](http://www.esa.int/SPECIALS/SME/SEMZSY7QQE_0.html) (last visited Mar. 1, 2010).

163. *See generally* Consultative Comm., Eur. Free Trade Ass’n, No. 1081190, Opinion on a Single Market for the 21st Century (June 30, 2008), available at <http://www.efta.int/~media/Documents/advisory-bodies/consultative-committee/cc-opinions/cc-opinion-internalmarket-june08.ashx>.

164. *A Strategy for the European Defence Technological and Industrial Base*, *supra* note 72.

165. U.K. TENDERING GUIDE, *supra* note 42, at 1.

166. *Id.*

U.S. arrangements for such offices have emphasized their specialization in matters related to small business, relative independence, direct reporting to top decision makers such as the president or agency secretaries, and oversight powers. European arrangements, on the other hand, have emphasized the substantive relationship between small business procurement assistance and other policies, such as innovation or development of domestic industries. Independence and direct reporting to top leadership have not been emphasized. As a result, European small business programs have the potential to be driven by non-small business concerns.

## V. AVAILABILITY OF SUITABLE CONTRACTS

In the context of public procurement, one of the threshold issues for small businesses is the ability to access contracts suitable to the business capabilities of such enterprises. It goes without saying that such work must be, in fact, available. Whether suitable work is available depends on the size or monetary value of contracts, and, to a lesser extent, on the complexity of geographic and performance requirements. Both U.S. and European authorities have pursued limitations on contract awards in order to assure their suitability for small firms. These approaches have a common “good government” concern over fairness and equality of competition, but there are also many differences.

### A. *The U.S. Approach: Addressing Contract Bundling and Consolidation*

As early as the 1940s and 50s, congressional leadership recognized that contract bundling, or “the size of various procurements,” was an obstacle to the entry of small firms into the federal market.<sup>167</sup> Today, FAR Part 19 directs Contracting Officers to ensure equitable opportunity for small firms by dividing “proposed acquisitions of supplies and services (except construction) into reasonably small lots (not less than economic production runs) to permit offers on quantities less than the total requirement.”<sup>168</sup>

Legislative policy aimed at reducing contract bundling was, in effect, enacted into law by the Competition in Contracting Act (“CICA”) of 1984.<sup>169</sup> Interpreting CICA, the comptroller general opined that bundling contract requirements in excess of the agency’s minimum needs to have the require-

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167. Saltonstall Lecture, *supra* note 81, at 6 (calling for multiple awards to smaller firms instead of awards based on a single large bid).

168. FAR 19.202-1. There is a disagreement within the executive branch as to whether partial small business set-asides resulting from severability of contracts into lots can be implemented in multiple-award contracts or services contracts. See ACQUISITION ADVISORY PANEL, REPORT OF THE ACQUISITION ADVISORY PANEL TO THE OFFICE OF FEDERAL PROCUREMENT POLICY AND THE UNITED STATES CONGRESS 299 n.116 (2007), available at [https://www.acquisition.gov/comp/aap/24102\\_GSA.pdf](https://www.acquisition.gov/comp/aap/24102_GSA.pdf).

169. See Competition in Contracting Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984) (codified as amended at 10 U.S.C. §§ 2304–2305, 41 U.S.C. § 253 (2006)).

ments performed together violated CICA's requirement for full and open competition.<sup>170</sup> CICA anti-bundling protections apply to both large and small firms, and bundling in violation of CICA is impermissible even if the requirements are bundled in a small business set-aside contract that excludes smaller small businesses (qualified under a NAICS code with a smaller size standard cap) in favor of larger small businesses (qualified under a NAICS code with a larger size standard cap).<sup>171</sup>

Finally, congressional anti-bundling policy was explicitly enacted into law by the Small Business Reauthorization Act of 1997.<sup>172</sup> The Small Business Act defines contract bundling to mean "consolidating two or more procurement requirements for goods or services previously provided or performed under separate, smaller contracts, in a solicitation of offers for a single contract that is unlikely to be suitable for award to small business."<sup>173</sup>

The Act calls on agencies to pay particular attention to factors "that might cause unsuitability for award to small business," such as "the diversity, size, or specialized nature" of performance called for in the contract, the total dollar value of the contract, the geographic spread of performance, or a combination of these factors.<sup>174</sup> To reduce contract bundling and the resulting denial of opportunities for small firms, the Act directs each federal agency, to the maximum extent practicable, to "(1) structure contracting requirements to facilitate competition by and among small business concerns, taking all reasonable steps to eliminate obstacles to their participation; and (2) avoid unnecessary and unjustified bundling of contract requirements that may preclude small business participation in procurements as prime contractors."<sup>175</sup> Contracts set aside for small businesses are not considered bundled under the Small Business Act.

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170. See, e.g., Phx. Scientific Corp., B-286817, 2001 CPD ¶ 24, at 8–10 (Comp. Gen. Feb. 22, 2001); Pac. Sky Supply, Inc., B-228049, 87-2 CPD ¶ 504, at 3–5 (Comp. Gen. Nov. 23, 1987).

171. See Vantex Serv. Corp., B-290415, 2002 CPD ¶ 131 (Comp. Gen. Aug. 8, 2002).

172. Small Business Reauthorization Act of 1997, 15 U.S.C. § 632(o) (1998); see also CONTRACT BUNDLING REPORT, *supra* note 146, at 2 n.1 (citing the Small Business Reauthorization Act as legislative authority).

173. CONTRACT BUNDLING REPORT, *supra* note 146, at 2 (citing the Small Business Reauthorization Act). Specifically, 15 U.S.C. § 632(o) provides the following definitions:

(1) Bundled contract. The term "bundled contract" means a contract that is entered into to meet requirements that are consolidated in a bundling of contract requirements. (2) Bundling of contract requirements. The term "bundling of contract requirements" means consolidating 2 or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small-business concern due to—(A) the diversity, size, or specialized nature of the elements of the performance specified; (B) the aggregate dollar value of the anticipated award; (C) the geographical dispersion of the contract performance sites; or (D) any combination of the factors described in subparagraphs (A), (B), and (C). (3) Separate smaller contract. The term "separate smaller contract," with respect to a bundling of contract requirements, means a contract that has been performed by 1 or more small business concerns or was suitable for award to 1 or more small business concerns.

174. CONTRACT BUNDLING REPORT, *supra* note 146, at 2.

175. *Id.*

In 2002, then-President George W. Bush placed a renewed emphasis on reducing contract sizes with his Small Business Agenda and one of its major elements, the Initiative Against Contract Bundling.<sup>176</sup> In the *Contract Bundling Report* prepared for the president, the OFPP outlined an action plan to deal with contract bundling in the executive branch. This plan included

accountability of senior agency management for improving contracting opportunities for small businesses through periodic reports on bundling to, the Office of Management and Budget, and the Small Business Administration; reporting of contract bundling information through the President's Management Council, composed of deputy heads of 26 major federal executive agencies; regulatory proposals to require contract bundling reviews for task and delivery orders under multiple-award contract vehicles; regulatory changes, in consultation with the SBA and the agency OSDBUs, to provide for review of acquisitions between \$2 and \$7 million for contract bundling; and additional regulatory changes to identify "alternative acquisition strategies for the proposed bundling of contracts above specified thresholds and written justification when alternatives involving less bundling are not used."<sup>177</sup>

The *Contract Bundling Report* also called for greater efforts to mitigate the effects of contract bundling, such as increased compliance with subcontracting plans by making compliance a factor in future awards; facilitation of small business teams and joint ventures (e.g., by extending the time necessary to organize teams for particular procurements); identification of best practices for maximizing small business opportunities; and dedication of the agency OSDBUs to the president's Small Business Agenda.<sup>178</sup>

Congress took further action to reduce contracts unsuitable for small firms by enacting special restrictions on contract consolidation by the Department of Defense in section 801 of the National Defense Authorization Act for Fiscal Year 2004.<sup>179</sup> This statute generally prohibits consolidation of two or more contract requirements totaling over \$5 million unless appropriate market research is conducted, alternatives to consolidation are identified, and senior-level determinations are made that consolidation is necessary and justified.<sup>180</sup> The Small Business Jobs Act of 2010 recently imposed additional transparency and oversight requirements on bundled contracts, and replicated section 801 for civilian agencies while lowering the threshold government-wide to \$2 million.<sup>181</sup> CICA and other statutes regulating

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176. *Id.* at 9–10.

177. *See id.* at 8–9.

178. *See id.* at 9–10.

179. *See* National Defense Authorization Act for Fiscal Year 2004, Pub. L. No. 108-136, § 801, 117 Stat. 1538, 1539 (2003) (codified at 10 U.S.C. § 2382).

180. *Id.*

181. *See* Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 1313, 124 Stat. 2504, 2538. Section 1313 authorizes DoD to follow the \$5 million threshold in 10 U.S.C. § 2382 once it meets the statutory government-wide small business goals. Section 1313 also requires all agencies to publicly post justification of bundled contracts, strengthens the SBA Procurement Center Representative program, and requires a government-wide policy on bundling.

contract bundling or contract consolidation are implemented in the SBA Government Contracting Programs regulations, the FAR, and the Defense Federal Acquisition Regulation Supplement (DFARS).<sup>182</sup> Finally, section 820 of the National Defense Authorization Act for Fiscal Year 2010 requires Contracting Officers to publish justifications of contract bundling and explanations of any benefits derived on any bundled contracts that use Department of Defense appropriations.<sup>183</sup>

### B. *The European Approach: Addressing Contract Suitability*

In Europe, one of the driving principles behind the procurement system of the EU and its Member States is “equal treatment.” With regard to the suitability of SMEs, some European commentators have argued that this principle means equal treatment to companies regardless of not only their geographic origin, but also economic power or size.<sup>184</sup> This interpretation has been explicitly recognized in a recent policy study performed by EIM Business and Policy Research Company with commission by the Enterprise Directorate-General of the European Commission.<sup>185</sup> The study cited the *Sixth Report (2000) of the European Observatory for SMEs*, which identified “the larger size of the contracts” as one of the key obstacles faced by small business in Europe, thus drawing the following conclusion: “It appears that the most important reason why SMEs do not try to participate in European tenders is that the projects are too large.”<sup>186</sup>

According to the EIM study of 2001 data, a typical SME contract award equals €249,000, while a typical large enterprise award equals about twice that—€453,000.<sup>187</sup> The median size of contracts advertised on Europe’s TED

182. See, e.g., 13 C.F.R. § 125.2 (2010); FAR 6.101, 7.103, 10.001, 19.202-1; DFARS 207.170, 219.201.

183. National Defense Authorization Act for Fiscal Year 2010, Pub. L. No. 111-84, § 820, 123 Stat. 2410 (2009) (to be codified in scattered sections of U.S.C.).

184. See, e.g., Burgi, *supra* note 63, at 287. This would be the case, for example, if SME tenders, in contrast to tenders of major companies, were verified as most economically advantageous tenders only because of a financial or other economic preference for SMEs. This procedure would infringe the provisions of the Public Sector Directive and the Utilities Directive, since the contract award criteria for the most advantageous economic tender must refer only to the subject matter of the public contract in question. Generally admissible criteria such as service and on-call maintenance can have an SME-friendly effect, however. Because of the danger of indirect discrimination, award criteria may only be justified by arguments that are linked to the subject of the public contract in question and not by the argument of SME friendliness or local settlement. The contrary position is argued by Ciara Kennedy-Loest, *supra* note 63, at 122–3 (arguing that procurement measures favoring SMEs at contract size, teaming, qualification, award, and performance stages could be justified on a case-by-case basis because they would carry out the objective of “opening up of public procurement to competition” as stated in the Public Procurement Directive, *supra* note 48).

185. See generally EIM FINAL REPORT, *supra* note 37.

186. *Id.* at 79.

187. *Id.* at 44.

database is somewhere between the two—€345,000.<sup>188</sup> According to the same database, the buyers with the most SME-friendly median are the armed forces (at €281,000), while local authorities tend to have somewhat higher medians (€306,000).<sup>189</sup> Because sixty percent of TED-advertised contract awards were made by local authorities, these authorities have the most ability to improve contract opportunities for small business by reducing contract size.<sup>190</sup>

Historically, Europe has not had a unified policy on contract size reduction. The EIM study found that while about eighty-five percent of public authorities surveyed try to provide size reduction assistance, the extent of these efforts varies widely among different Member States.<sup>191</sup> According to the EIM study,

[t]hroughout Europe, hardly any calls for tender are *divided into smaller lots* . . . In twelve of the Member States [including the U.K., Sweden, Spain, Portugal, Netherlands, Italy, Ireland, France, Finland, Denmark, Belgium, and Austria], this is done casually (whereby France is characterized by an increasing tendency towards the division of public procurement contracts into lots), in two of them (Luxembourg and Greece) none of the tenders are divided. Only in Germany, division of tenders into lots is done often, resulting in a comparatively small average contract size.<sup>192</sup>

Coupled with the fact that the median contract size in Ireland was reported as higher than the average of the Member States,<sup>193</sup> these data suggest that larger European nations tend to be much better at breakouts than smaller nations.

Recently, however, both the EU and national authorities began a concerted effort to pursue breakups of consolidated contracts (also known as contract splitting) as a major tool of procurement assistance for SMEs.

To a varying extent, contracting authorities have increasingly started to bundle their demands. . . . [t]he contracting entities can easily, without any legislative changes, create an SME-friendly environment by abandoning or dismantling such [bundled] structures. . . . If the responsible contracting officer does decide to purchase [this] demand by a central purchasing body or by advertising an extensive framework agreement, the SME-endangering effect could be neutralised by a separating the resulting contracts into trade-specific or partial lots.<sup>194</sup>

For instance, as stated above, article 11 of the European Defense Agency's 2006 Code of Best Practice in the Supply Chain calls for participation of SMEs and other qualified suppliers in procurements "where competition is efficient, practical, and economically or technologically appropriate on a level playing-field basis."<sup>195</sup> Further, the Small Business Act for Europe stated that "Member States are invited to . . . encourage their contacting authorities

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188. *Id.* at 18.

189. *Id.*

190. *Id.* at 14.

191. *Id.* at 120.

192. *Id.* at 79.

193. *Id.* at 216.

194. Burgi, *supra* note 63, at 289–90.

195. CoBPSC, *supra* note 71, at 3.

to subdivide contracts into lots where it is appropriate and to make subcontracting opportunities more visible, [as well as to] remind their contracting authorities of their obligation to avoid disproportionate qualification and financial requirements.”<sup>196</sup> Based on express but general authorizations in the Public Procurement Directives, the European Code of Best Practices advocates three strategies to overcome SMEs’ difficulties related to the size of large government contracts: (1) subdividing of contracts into lots and authorizing of contractors to compete for an unlimited number of lots; (2) grouping or teaming of small contractors;<sup>197</sup> and (3) conclusion of framework agreements, known in the United States as multiple-award contracts, with SMEs in addition to agreements with large businesses.<sup>198</sup> According to the European Code of Best Practices, the first strategy was supported by laws or best practices from countries including Austria, France, Hungary, Romania, Lithuania, and Ireland.<sup>199</sup> Likewise, the European Code of Best Practices provided that the second strategy was supported by the EU business partnering initiative called the Enterprise Europe Network.<sup>200</sup> The third strategy, per the Code, was supported by laws or best practices from the United Kingdom, Germany, and Romania.<sup>201</sup> The European Code of Best Practices also advocates greater visibility of subcontracting opportunities and greater equity in subcontracting. This strategy was supported by best practices from Romania,

196. “*Small Business Act*” for Europe, *supra* note 58, at 10–11.

197. See Burgi, *supra* note 63, at 290 (“From an SME point of view, this instrument is very interesting as a tool for their promotion, especially if it is ensured normatively or by means of the contracting authority’s behaviour that groups of economic operators are as equally treated as single bidders. The Procurement Directives expressly legitimise the formation of groups of economic operators.” (citing Public Procurement Directive, *supra* note 48, art. 4(2))).

198. *Eur. Code of SME Best Practices*, *supra* note 12, at 6–9.

199. See *id.* at 7–8. Indeed, German law appears to require not only the splitting of prime contracts into partial and trade lots in order protect SME interests, but also requires Contracting Officers to obligate prime contractors to conduct competitive subcontracting of the prime contractors who do not subdivide their contracts into such lots. BAKER & MCKENZIE, *supra* note 63, at 72 (citing Gesetz gegen Wettbewerbsbeschränkungen [German Act Against Restraints on Competition], 26 Aug. 1998, BUNDESGESETZBLATT, Teil I [BGBl. I] at 2546, § 97(3) (Ger.)). In France,

Article 10 of the Public Procurement Contracts Code establishes the following principle: “in the interests of the broadest possible competition, and unless the object of the contract does not lend itself to the identification of distinct lots, the contracting authority may award the contract in separate lots.” The main aim of this article is to make public procurement more accessible to small and medium-sized enterprises (SMEs) not necessarily equipped to perform the full extent of a public contract.

FR. MINISTRY OF ECON., INDUS., & EMP’T, PUBLIC PROCUREMENT CONTRACTS AND ACCESS TO EMPLOYMENT FOR PERSONS EXCLUDED FROM THE LABOR MARKET: GUIDE FOR THE USE OF PUBLIC PURCHASERS PRODUCED BY THE WORKSHOP ON SOCIAL ASPECTS OF PUBLIC PROCUREMENT CONTRACTS 15 (July 2007), available at [http://www.uzuvrh.hr/userfiles/file/public%20procurement\\_contracts\\_access\\_employment.pdf](http://www.uzuvrh.hr/userfiles/file/public%20procurement_contracts_access_employment.pdf).

200. *Eur. Code of SME Best Practices*, *supra* note 12, at 8.

201. See *id.* at 9. For instance, Romania issued guidance requiring contracting agencies to peg the contractors’ minimum required level of ability at the size and scope of the largest order instead of the entire framework agreement, Germany awarded framework agreements specifically for small-scale services, and the UK established an office furniture framework agreement specifically including large suppliers of standard items as well as SME specialist contractors.

the United Kingdom, and Germany.<sup>202</sup> Similar pro-SME contract splitting and multiple-award framework agreements are recommended by the U.K. Office of Government Commerce as measures to overcome over-dependency on traditional, large suppliers.<sup>203</sup>

### C. Comparison

It appears that the historic European approach to ensuring the suitability of contracts for small businesses by means of voluntary compliance with system-wide recommendations closely resembled the approach pursued by the United States during the 1940s and 1950s. Presently, Europeans are transitioning towards hybrid measures, which resemble the Competition in Contracting Act (“CICA”) and the section 801 defense contract consolidation statute in terms of competition standards and breakup remedies, but also resembling the Small Business Act in that these measures are invoked specifically (if not exclusively) for the benefit of SMEs. While the two transatlantic systems share the goal of promoting fairness in public procurement, the United States’ anti-bundling efforts are driven by additional considerations of promoting business ownership, ensuring a robust supplier base, and making the economic strengths of small enterprises available to the public sector. It appears that the current U.S. approach on legislative and regulatory standards, requiring Contracting Officers to measure benefits and costs of bundling pursuant to the Small Business Act,<sup>204</sup> has more “teeth” than the European approach. However, this appearance may be deceptive, as no comprehensive bundling enforcement data were available at the time of this writing. Nonetheless, further strengthening contract suitability policies by legislation appears to be the next natural step for the authorities of united Europe and its Member States as well as for the United States.

## VI. SMALL BUSINESS PRIME CONTRACTING GOALS, SET-ASIDES, AND RESERVATIONS

In light of the European Commission’s trade rhetoric against SME set-asides and goals, one might expect that SME set-asides do not exist in Europe. Such expectation would be incorrect, as both the United States and Europe have long had small business set-asides, goals, targets, or reservations in various forms.

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202. *See id.* at 10. For instance, Germany requires prime contractors to extend no less favorable payment and other terms to their subcontractors. The United Kingdom encourages publication of potential subcontracting opportunities on agency websites, and, from time to time, requires main suppliers to show they have a proven track record of achieving value for money through effective utilization of the supply chain, including SME subcontractors.

203. *See* PROCUREMENT POLICY UNIT, U.K. OFFICE OF GOV’T COMMERCE, GUIDELINES ON FACTORS THAT CAN BE CONSIDERED WHEN TRYING TO REDUCE THE RISK OF OVER-DEPENDENCY ON A SUPPLIER 1–8 (July 2004), available at [http://ogc.gov.uk/documents/Guidance\\_to\\_reduce\\_the\\_risks\\_of\\_over-dependency\\_on\\_a\\_supplier.pdf](http://ogc.gov.uk/documents/Guidance_to_reduce_the_risks_of_over-dependency_on_a_supplier.pdf); Kennedy-Loest, *supra* note 63.

204. 15 U.S.C. §§ 631–657o (2006).

A. *The U.S. Approach: A Tradition of Goals and Set-Asides; Size or Status as Eligibility or Responsibility Criteria*

Since the late 1940s, Congress has directed agencies to award a “fair share” or “fair proportion” of government contracts or orders and to provide for “equitable” or “greatest possible” small business participation in a string of procurement statutes. However, in the absence of a statutory numerical target, the annual portion of small business prime contracts fluctuated widely. In the defense procurement, for instance, these awards ranged from sixteen percent to thirty-two percent every year for over ten years following the end of World War II.<sup>205</sup> By comparison, the small business share in defense contracts is currently in the low twentieth percentile.<sup>206</sup> In 1978, the Small Business Act amendments directed the establishment of annual small business procurement goals for federal agencies.<sup>207</sup> The Business Opportunity Development Reform Act of 1988<sup>208</sup> established a government-wide small business prime contracting goal of no less than twenty percent. The Small Business Reauthorization Act of 1997<sup>209</sup> increased the government-wide statutory small business goal to no less than twenty-three percent of all prime contracts. Congress also established goals for specific small business categories, as discussed below.

Congress and the executive branch have authorized or required small business set-asides as means to obtain fair share objectives and defense or civilian industrial base objectives. The Small Business Act broadly provides that

to effectuate the purposes [of the Act,] . . . small-business concerns . . . shall receive any award or contract or any part thereof, and be awarded any contract for the sale of Government property, as to which it is determined by the [Small Business] Administration and the contracting . . . agency (1) to be in the interest of maintaining or mobilizing the Nation’s full productive capacity, (2) to be in the interest of war or national defense programs, [or] (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government in each industry category are placed with small-business concerns. . . . These determinations may be made for individual awards or contracts or for classes of awards or contracts.<sup>210</sup>

In 1984, the White House Office of Federal Procurement Policy amended the Federal Acquisition Regulation to implement this legislation on a class basis by creating the so-called Rule of Two.<sup>211</sup> The Rule of Two requires the

205. Saltonstall Lecture, *supra* note 81, at 11.

206. See *DOD Program Goals and Statistics*, U.S. DEP’T OF DEF., <http://www.acq.osd.mil/osbp/statistics/goals.htm> (last visited Feb. 20, 2010) (showing that small firms received 22.375% in fiscal year 2009).

207. OFFICE OF SMALL BUS. PROGRAMS, ARMY MATERIEL COMMAND, SMALL BUSINESS PROGRAM GUIDE FOR GOVERNMENT AND INDUSTRY 6 (2008), available at <http://www.amc.army.mil/pa/SMALLBUSINESS.asp>.

208. Business Opportunity Development Reform Act of 1988, Pub. L. No. 100-656, § 502, 102 Stat. 3881 (1988) (codified as amended at 15 U.S.C. § 644(g) (2006)).

209. Small Business Reauthorization Act of 1997, Pub. L. No. 105-135, 111 Stat. 2592 (1997) (codified as amended at 15 U.S.C. § 644(j)).

210. 15 U.S.C. § 644(a).

211. FAR 19.502-2 (1984).

set-aside of any acquisition over \$100,000 “when there is a reasonable expectation that (1) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns . . . and (2) award will be made at fair market prices.”<sup>212</sup> For set-asides in the R&D sector, “there must also be a reasonable expectation of obtaining from small businesses the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performance, and schedule.”<sup>213</sup> The Rule of Two applies to task order competition in multiple-award contracts.<sup>214</sup> Partial set-asides are also required where a total set-aside is not appropriate, but contracts can be broken up into lots that are appropriate for set-asides.<sup>215</sup> Further, the FAR requires set-asides based on fair proportion, national defense, or national capacity grounds.<sup>216</sup> The SBA regulations also encourage federal agencies to consider a small business reservation on multiple-award contracts by “reserving one or more awards for small companies when issuing multiple awards under task order contracts.”<sup>217</sup>

Over time, Congress began to establish another so-called small business reservation by requiring that small contracts below a certain dollar amount be exclusively set aside for small businesses. The set-aside amount was originally set at \$25,000.<sup>218</sup> In the Federal Acquisition Streamlining Act of 1994, Congress amended the Small Business Act to reserve, or set aside, all contracts between \$2,500 (sometimes known as the Micro-Purchase Threshold (“MPT”)) and \$100,000 (also known as the Simplified Acquisition Threshold) for awards to small firms in which two or more responsible small firms are available.<sup>219</sup> The \$2,500 MPT has since been adjusted for inflation to \$3,000, and the reservation range was adjusted to between \$15,000 and \$250,000 for contracts related to contingency operations or support of defense or recovery from nuclear, chemical, biological, or radiological attacks.<sup>220</sup>

Socioeconomic goals and set-aside procedures in the Small Business Act have been reinforced by special legislation for the Department of Defense, the Coast Guard, and the National Aeronautic and Space Administration in 10 U.S.C. § 2323. Among other things, section 2323 requires these agencies

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212. FAR 19.502-2(b).

213. *Id.*

214. *See* Delex Sys., Inc., B-400403, 2008 CPD ¶ 181 (Comp. Gen. Oct. 8, 2008); Memorandum from President William J. Clinton on Continued Commitment to Small, Small Disadvantaged, and Small Women-Owned Businesses in Federal Procurement, 59 Fed. Reg. 52,397 (Oct. 13, 1994) (announcing continued commitment to small business set-asides upon signing of the Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, 108 Stat. 3324).

215. FAR 19.502-.503.

216. FAR 19.502-1(a)(1).

217. 13 C.F.R. § 125.2(b)(6)(i)(C) (2010).

218. FAR 19.502-2(c).

219. Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, 108 Stat. 3324 (codified as amended at 41 U.S.C. § 15) (implemented in FAR 19.502-2(a)).

220. FAR 19.502-2(a).

to ensure that contract dollars and numbers of awards granted under the small business set-aside program are maintained.<sup>221</sup>

B. *The European Approach: Warming Up to Goals and Set-Asides; Effective Set-Asides; and Size or Status of Team Members as Award Criteria*

Historically, Europeans shied away from adopting general small business goals or set-asides at the prime contracting level. Objections in European literature on this subject primarily reflect academic policy arguments such as potential economies of scale, the need to ensure that large businesses are treated no less equally than SMEs, and administrative efficiency; but there is also European literature with contrary policy arguments such as security of supply, competitive industrial base, and economic development.<sup>222</sup> Furthermore, over the last two decades the European Court of Justice has clarified that it is willing to allow set-asides, preferences, or goals based on collateral policies if the EC endorses these policies.<sup>223</sup> This position apparently remains prevalent at

221. See DFARS 219; NMCARS 5219.000; NFS 1819.201; HSAR 3019.201. The exception to the normally pro-set-aside procurement regulations was the now-repealed Small Business Competitiveness Demonstration Program, which forces small firms to compete with large businesses in certain sectors. See generally FAR 19.10.

222. Compare Nicholas Hatzis, *The Legality of SME Development Policies Under EC Procurement Law*, in SOCIAL AND ENVIRONMENTAL POLICIES IN EC PROCUREMENT LAW: NEW DIRECTIVES AND NEW DIRECTIONS 345, 347 & n.10 (Sue Arrowsmith & Peter Kunzlik eds., 2009), with EC, *Commission Communication on Promoting SME Participation in Public Procurement in the Community*, at 2, COM (90) 166 final (May 7, 1990), available at [http://aei.pitt.edu/3708/01/000269\\_1.pdf](http://aei.pitt.edu/3708/01/000269_1.pdf). In that Communication, the Commission rejected SME-favoring measures at the prime contracting level such as reservations, set-asides, price evaluation preferences, and “indirect discrimination [which] could arise where SMEs predominate among the enterprises of a region or locality that is itself the subject of preference.” *Id.* at 4. The main argument was a criticism of U.S.-style small business preferences on policy grounds such as administrative costs, economies of scale and other competitive benefits of large businesses, and alleged disincentives for modernization and productivity improvements. See *id.* However, the Communication rejected these same arguments in favor of mandatory subcontracting with SMEs.

223. See *EC Communication on Promoting SME Participation*, *supra* note 222. The European Commission has argued that unspecified “certain preference regimes” were contrary to “Community law” and the Treaty based on the European Court of Justice decision in *DuPont de Nemours Italiana Spa v. Unita Sanitaria Locale No. 2 Di Carrara*, Case C-21/88, 1990 ECR I-889. Again, that decision concerned a domestic preference. Further, in *PreussenElektra AG v. Schleswag AG*, 2001 2 C.M.L.R. 36, the European Court of Justice distinguished the invalid requirement that percentage of a product be obtained from a domestic supplier at issue in *DuPont de Nemours Italiana Spa* from the valid requirements to purchase from renewable energy sources within the supply area of public and private electricity suppliers. See Case C-21/88, 1990 E.C.R. I-889, at 900–02. The renewable energy requirements were validated thanks, in part, to the policy statements from the European Commission encouraging renewable energy. See *id.* However, the Communication noted that “SMEs increasingly gain access to larger public contracts through sub-contracting . . . [and t]he public procurement directives leave Member States a wide freedom to pursue an active policy of encouraging local sub-contracting.” *EC Communication on Promoting SME Participation*, *supra* note 222, at 6, ¶ 22. The Commission found support for SME subcontracting preferences in a European Court of Justice decision that approved the use of mandatory contract conditions and award criteria requiring the use of long-term unemployed, provided these conditions/criteria were fully disclosed in advance in the solicitation and were not discriminatory on the basis of nationality. See *Gebroeders Beentjes BV v. Netherlands*, 1988 E.C.R. 4652,

this time, and the forty-two percent level of SME participation in European public procurement prime contracts as of fiscal year 2005<sup>224</sup> does not present a compelling case for across-the-board goals or set-asides. However, when it comes to critically important markets such as R&D or the space industry, the Europeans are firmly committed to SME-targeted measures including set-asides and goals. Europeans have, however, provided state aid targeted at SMEs, including SMEs that act as public procurement suppliers. Further, as discussed in other sections, Europeans prefer to utilize SME participation by including the value-for-money award analysis as one contract-by-contract socioeconomic criterion. As addressed in other sections, the Europeans prefer to use binding SME subcontracting targets that resemble both goals and set-asides, to be imposed on a contract-by-contract basis.

As observed just six years ago, “[s]ince the Competition Law does not allow direct support of access of SMEs to public contracts, policy instruments have to be concentrated on lowering the obstacles for SMEs on the public procurement market.”<sup>225</sup> The EC’s procurement directives, which regulate acquisitions of various types of products or services in Member States, “have been interpreted as allowing for little, if any role for policies intended to assist SMEs in the European Community.”<sup>226</sup> This stance is primarily attributable to the EC’s intent to use the directives in order to secure the benefits of liberalizing national procurement markets. Under this system, SME preferences by national procurement authorities have been disfavored as contrary to the principle of equal treatment of firms from each Member State. Indeed, “[m]ember state programmes designed to provide preferences for domestic firms or restrictions on entry of the firms of other Member States in procurement may be subject to challenge by the EC Commission as an infringement of the directives.”<sup>227</sup> The European Commission formerly deemed national-firm preferences on contracts above the European-wide thresholds to be contrary to the requirements of the Procurement Directives then in force.<sup>228</sup>

However, as noted by the International Trade Center of the United Nations Conference on Trade and Development and the World Trade Organization, the Europeans have not been against SME set-asides in principle:

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4661. Thus, to date, there appears to be no European Court of Justice precedent precluding SME set-asides or goals in civilian or dual-use procurements as a matter of the EC Treaty.

224. *Eur. Code of SME Best Practices*, *supra* note 12, at 4.

225. CAROLINE BRENNAN, *SME UNION, SUCCESSES AND CHALLENGES FOR SMEs* 56 (revised by Alexandra Fally, 2003), available at <http://www.sme-union.org/viewdoc.php?LAN=en&FILE=doc&ID=2>.

226. INT’L TRADE CTR. OF THE U.N. CONFERENCE ON TRADE & DEV. (UNCTAD) & WORLD TRADE ORG. (WTO), *SME & EXPORT-LEAD GROWTH: ARE THERE ROLES FOR PUBLIC PROCUREMENT PROGRAMMES? A PRACTICAL GUIDE FOR ASSESSING AND DEVELOPING PUBLIC PROCUREMENT PROGRAMMES* 49 (2002), available at [http://www.wto.org/english/tratop\\_e/gproc\\_e/wkshop\\_tanz\\_jan03/itcdemo3\\_e.pdf](http://www.wto.org/english/tratop_e/gproc_e/wkshop_tanz_jan03/itcdemo3_e.pdf).

227. *Id.*

228. *Id.*

[The European Commission] does not appear to rule out the possibility of preferential measures for SMEs for procurements below the threshold of application as set forth in the directives. For acceptance by the EC Commission, such programmes would likely require clear definitions of qualifying SMEs, compatibility among national regimes, and strict conformity with EC treaty requirements on transparency, equality of treatment, and non-discrimination.<sup>229</sup>

Within the space industry, SME set-asides have a long history at the European Space Agency. The ESA has awarded at least two types of SME prime contracting set-asides. The first type of set-asides is the EC-supported “exploratory awards” under €30,000 reserved solely to “non-primers” (including SMEs).<sup>230</sup> The second type of set-asides is the Leading-Edge Technologies from Small and Medium-Sized Enterprises (“LET-SME”) Announcements of Opportunity up to €200,000 for a period of six to eighteen months for technical adaptation, testing, or customization of technologies.<sup>231</sup> The LET-SME set-asides have been in existence since 1998.<sup>232</sup> Politically, ESA set-asides are also related to the principle of *juste retour*, or fair return on investment made by countries towards the ESA budget: “smaller countries tend to receive their fair return through contracts awarded to smaller companies.”<sup>233</sup>

Despite its professed antagonism to U.S. small business set-asides, the EC over time took several steps that make it easier to institute SME set-asides at the prime contracting level. For instance, over the last several years the EC has explicitly promoted several R&D SME set-aside programs under the framework of Targeted Socio-Economic Research (“TSER”).<sup>234</sup> In 2006, the EC’s EU Scientific and Technical Research Committee observed that EC rules also provide for SME preferences in the context of state aid, that EU procurement rules are unclear on set-asides, and that “[t]he argument for preferential treatment of SMEs under the Community Framework for state aid for research

229. *Id.*; accord Interview with Jean-Pierre Jouyet, Fr. Minister of State for Eur. Affairs, by La Tribune Newspaper, in Paris, Fr. (July 5, 2007), <http://www.ambafrance-uk.org/Jean-Pierre-Jouyet-talks-to-La.html> (“Q.—What stage have we got to regarding the possibility of giving SMEs greater access to public procurement? The Minister—We have to find an appropriate legal mechanism allowing us to raise at the WTO the issue of having a European small business act as the Americans did when they managed to get their own small business act accepted in the WTO negotiations. With Brussels, it’s more a matter of legal adjustment than one of principle.”).

230. See Petrou, *supra* note 63, at 150 nn.46–51.

231. LET-SME: *An Opportunity Reserved for SMEs*, Eur. Space Agency, [http://www.esa.int/SPECIALS/Business\\_Opportunities/SEM7ND8LURE\\_0.html](http://www.esa.int/SPECIALS/Business_Opportunities/SEM7ND8LURE_0.html) (last visited Aug. 19, 2009).

232. See *id.*

233. Petrou, *supra* note 63, at 170; accord SELECT COMM. ON TRADE & INDUS., TENTH REPORT—U.K. SPACE POLICY, 1999–2000, H.C. 335, ¶ 22 (U.K.), available at <http://www.publications.parliament.uk/pa/cm199900/cmselect/cmtrdind/335/33510.htm> (“ESA largely (and historically) operates on the principle of ‘juste retour’: the principles that the proportion of contracts under a particular program awarded to firms from a given country is in proportion to the funding that country has contributed to the program.”).

234. Petrou, *supra* note 63, at 150 n.48 (citing SME set-asides under the EC’s Fourth and Fifth Research & Development Framework Programs).

and development can be similarly applied to public procurement.<sup>235</sup> Also, the EU legal framework apparently authorizes the equivalent of the low-value small business reservation authority<sup>236</sup> in the United States: “Set-asides are legal under European procurement legislation for contracts below European thresholds. However, this use must not discriminate against SMEs from other Member States.”<sup>237</sup>

Indeed, although the Public Procurement Directive,<sup>238</sup> the Defense Procurement Directive,<sup>239</sup> and the European Code of Best Practices<sup>240</sup> do not expressly authorize SME set-asides or goals, the directives and the European Code of Best Practices combined with certain national procurement authorities can have the effect of set-asides for SMEs or teams involving SMEs. The effective SME team set-asides are created by operation of four types of provisions: provisions favoring consideration of social factors in procurement, requirements for mandatory subcontracting with SMEs, provisions encouraging splitting contracts into lots and placing limitations on lots, and provisions encouraging SME participation by groupings of bidders.

EU Member States appear open to the possibility of instituting SME procurement goals within their nations as well as across Europe. The leading advocate for this sentiment is French President Nicholas Sarkozy, who has taken the position that SME set-asides, goals, and preferences in public procurement are consistent with free trade and competition principles:

Now there are things the Americans do which I've never understood us not doing in Europe. Let me take the Small Business Act: the Americans advocate freedom, but that doesn't prevent them—and I think they're right—from defending small and medium-size companies and reserving a proportion of public procurement for them. I'm not telling you that you are wrong; I'm saying you're right. What do I want for Europe? For us to do the same thing! Because a country needs large groups, but also a fabric of SMEs. You are a great free-trade country, but, in fact, you have adopted different fiscal legislation for products manufactured in your country from those which aren't! I think you're right! Because, after all, it's the State's job to support its companies.<sup>241</sup>

235. EU SCIENTIFIC & TECH. RESEARCH COMM. (CREST), EC, DESIGN MEASURES TO PROMOTE GROWTH OF YOUNG RESEARCH-INTENSIVE SMEs AND START-UPS: REPORT OF THE CREST EXPERT GROUP 16 (Mar. 2006), available at [http://www.insme.org/documenti/Promoting\\_Innovative\\_SMEs\\_&\\_Startup.pdf](http://www.insme.org/documenti/Promoting_Innovative_SMEs_&_Startup.pdf).

236. See FAR 19.502-2(a).

237. Andrew Erridge, *Involvement of SMEs in Public Procurement*, 7 PUB. PROCUREMENT L. REV. 37, 41 (1998).

238. Public Procurement Directive, *supra* note 48.

239. Defense Procurement Directive, *supra* note 49.

240. *Eur. Code of SME Best Practices*, *supra* note 12.

241. Nicolas Sarkozy, President of the Fr. Republic, Speech at His Meeting with the Members of the French-American Business Council During His Official Visit to the United States, Washington (Nov. 6, 2007), <http://www.ambafrance-uk.org/President-Sarkozy-s-speech-to-US.html>.

According to a 2006 comparative procurement survey through the European Public Procurement Network, Austria,<sup>242</sup> France,<sup>243</sup> Greece,<sup>244</sup> and Sweden<sup>245</sup> either have already adopted, or have been considering adoption of, SME goals, reservations, preferences, or special considerations. Further, in 2007, French President Nicholas Sarkozy and the French Government formally proposed that the European Commission authorize reservations of a portion of EU contracts for SMEs.<sup>246</sup> The French Government also has been seeking to negotiate an exemption from the World Trade Organization Agreement on Government Procurement for contracts set aside for European SMEs.<sup>247</sup> The set-aside proposal was not made part of the Small Business Act for Europe, but the concept of goals remained popular.<sup>248</sup> For instance, the U.K.'s former Labor Government has considered imposing an across-the-board thirty

242. 2006 Survey on National Public Procurement Regulations Favoring SMEs, PUB. PROCUREMENT NETWORK, <http://www.publicprocurementnetwork.org/b4-1.htm> (last updated 2006) (cached version accessed on Archive.org) (“Question: Is there in your country a regulation that favours or benefits SME’s (small or medium enterprises), for example by an obligation or otherwise (like contracts below certain thresholds are only for SME’s or 25 % of all contracts by a contracting authority have to be awarded to SME’s)? . . . Austria: No legal obligation to favor SME’s exists. Although in some cases SME’s are to be taken in due consideration.”).

243. *Id.* at 2 (“France: No, currently not (considering changes) but there are several general provisions that apply to all economic operators but are particularly useful for SME’s.”).

244. *Id.* (“Greece: Yes, there is a regulation as regards works and research contracts that favors SME’s through the obligatory registration of companies in classes depending on their size and the level of the budget of contracts sought. Thus, lower class registered companies can participate in competitions for contracts of lower budget where other, in higher-class registered companies may not.”).

245. *See id.* at 3 (“Sweden: No such regulation, but Sweden has adopted a secondary legislation within the system of government procurement of framework agreements, in which one phrase says: ‘In that connection (framework agreements—editors’ comment) the possibility of small and medium size enterprises to participate in the procurements shall be considered.’”).

246. *See, e.g., France Softens Its Stance on EU Small Business Act*, EURACTIV.COM (Jan. 28, 2008), <http://www.euractiv.com/de/node/219270>. Notably, French President Nicholas Sarkozy campaigned on the promise to set aside U.S.-style small business set-asides, reservations, and preferences in French procurement, and has spoken out in support of “positive discrimination” for SMEs, which received thirty-three percent of French public procurement dollars as of 2007. *See* Cyrille Emery, *PME: Sarkozy veut une discrimination positive et Alain Lambert veut supprimer le Code [SMEs: Sarkozy Wants Positive Discrimination and Alan Lambert Wants to Remove the Code]*, PUBLIC TENDERING.COM (Dec. 10, 2007), [http://www.publictendering.com/en/lionel-stoleru-il-est-urgent-damener-les-pme-a-fort-potentiel-sur-le-marche-mondial](http://www.publictendering.com/en/pme-sarkozy-veut-une-discrimination-positive-et-alain-lambert-veut-supprimer-le-code; Lionel Stoleru: ‘Il est urgent d’amener les PME à fort potentiel sur le marché mondial’ [Lionel Stoleru: It is Urgent to Bring SMEs with High Potential into the Global Market]</i>, PUBLIC TENDERING.COM (Jan. 7, 2008), <a href=). However, his set-aside plans were stymied by the World Trade Organization Agreement on Government Procurement and position of the French Council of State, and he had to settle for monitoring of agency SME contract award trends and more limited preferences at the present time. *See id.*

247. *See* FR. MINISTRY OF ECON., INDUS., & EMP’T, EUROPE FOR SMEs: SME ACCESS TO PUBLIC PROCUREMENT, A VITAL COMMITMENT 2 (2006), available at <http://www.insme.org/documents/Anglais22-9.pdf>.

248. *See, e.g., France Softens Its Stance on EU Small Business Act*, *supra* note 246.

percent prime contracting goal for SMEs.<sup>249</sup> In March 2008, the Chancellor of the Exchequer created the so-called Glover Committee to address this topic.<sup>250</sup> Ultimately, the Glover Committee concluded in November 2008 that a goal “would not be effective in improving SME participation in public procurement.”<sup>251</sup> However, that same month, the leader of the Conservative Party and current Prime Minister, David Cameron, proposed an “aspiration that twenty-five percent of Government contracts should be awarded to SMEs” similarly to the U.S. twenty-three percent goal.<sup>252</sup> Further, in April 2009, the 400-member U.K. House of Commons All-Party Parliamentary Small Business Group sought to expand on the Glover Committee’s conclusion concerning SME goals, and called on public authorities to set nonbinding, ambitious targets for SME contract awards.<sup>253</sup>

Another “set-aside light” measure gaining popularity in Europe is high-level monitoring of SME participation in public contracts without publicly available goals. Essentially, this is institutionalized oversight by national political leaders designed to pressure government agencies into more contracts for SMEs. For example, since 2006, the French Government has required government agencies to measure and report contract awards to SMEs.<sup>254</sup> Likewise, the 2007 *Responsible Purchasing Strategy* issued by the Scottish Parliament calls for regular measurement and reporting of SME contract awards, as well as evaluations of procurement officials on contracting with SMEs.<sup>255</sup> Thus, it appears likely that SME goals and set-asides will be expanded across Europe from R&D and space contracting into other types of procurements.

### C. Comparison

Without question, the United States has been the leader in applying procurement policy tools such as set-asides, reservations, and goals. However,

249. ADVISORY COMM. ON ACTION TO REDUCE BARRIERS TO SME PARTICIPATION IN PUB. PROCUREMENT, H.M. TREASURY, ACCELERATING THE SME ECONOMIC ENGINE: THROUGH TRANSPARENT, SIMPLE, AND STRATEGIC PROCUREMENT 3 (Nov. 2008) (U.K.).

250. *See id.*

251. *Id.*

252. *David Cameron Visits WEEE Recycling Firm in Kent*, LETSRECYCLE.COM (Nov. 5, 2008), [http://www.letsrecycle.com/do/ecco.py/view\\_item?listid=37&listcatid=354&listitemid=10623](http://www.letsrecycle.com/do/ecco.py/view_item?listid=37&listcatid=354&listitemid=10623).

253. *See* U.K. HOUSE OF COMMONS ALL-PARTY PARLIAMENTARY SMALL BUS. GRP., REPORT ON SME ACCESS TO PUBLIC PROCUREMENT 3 (Apr. 2009), available at [http://www.oxfordinstitute.org/pubs/about/public\\_affairs/unit/business\\_groups/inquiries/report.pdf](http://www.oxfordinstitute.org/pubs/about/public_affairs/unit/business_groups/inquiries/report.pdf). This Group includes members in both the House of Commons and the House of Lords.

254. CELINE IDE, SOULIER ADVOCATES, WILL THE EUROPEAN UNION SUCCEED IN IMPLEMENTING A MECHANISM OF SUPPORT FOR SMALL AND MEDIUM-SIZED BUSINESSES AS ALREADY IMPLEMENTED SINCE 1953 IN THE UNITED STATES? 1 (2008), available at [http://www.soulier-avocats.com/upload/documents/Article\\_CI\\_SBA\\_may\\_2008\\_final2.pdf](http://www.soulier-avocats.com/upload/documents/Article_CI_SBA_may_2008_final2.pdf) (“Decree No. 2006-975 of August 1, 2006 amended the French Public Procurement Code for a better access for SMEs to public procurement. The main amendments concerned: a) the subdivision of contracts into lots, b) the creation of more flexible rules for economic operators to prove their technical abilities . . . [and] c) the obligation for purchasers to measure and report on contracts awarded to SMEs.”).

255. *See* SCOTTISH PARLIAMENT, RESPONSIBLE PURCHASING STRATEGY 14–19 (2007), available at <http://www.scottish.parliament.uk/corporate/procurement/docs/Strategy-FINAL.pdf>.

the Europeans also utilize targeted policies such as set-asides or reservations, although on a smaller scale and in specific industry sectors such as space. Furthermore, top leaders in several major European nations currently support the concept of prime contracting goals. It is likely to see enactment in the near future. Finally, both Europe and the United States have emphasized small business set-asides in space procurements.

## VII. CONTRACTING WITH SMALL FIRMS FOR ECONOMIC SUSTAINABILITY AND REMEDIAL PURPOSES

Another aspect of small business contracting policy present both in the United States and in Europe is contracting for remedial and sustainability purposes. In this context, authorities in the United States typically direct contracts towards small businesses in certain categories closely related to remedial or sustainability objectives, while the European authorities appear to invoke remedial or sustainability objectives in order to contract with SMEs without further classifying SMEs into special categories.

### A. *The U.S. Approach: Small Business Socioeconomic Categories*

The procurement assistance provisions in the Small Business Act are not limited to helping small businesses in general; rather, they reach further to several specific subsets of the small business sector. These subsets include small disadvantaged businesses (“SDBs”) (firms owned and controlled by socially or economically disadvantaged individuals or by Native American tribes, Alaska Native Corporations, or Native Hawaiian Organizations); SDBs admitted in the SBA’s Section 8(a) Business Development Program; small businesses located in Historically Underutilized Business Zones (“HUBZones”) and employing HUBZone residents (“HUBZone small businesses”); small businesses owned and controlled by service-disabled veterans (“SDVOSBs”); and small businesses owned and controlled by women (“WOSBs”).<sup>256</sup> Congress has targeted these groups with preferential measures for a variety of social or economic reasons.

The executive branch implemented additional procurement assistance measures targeted at specific categories of small firms. For instance, President Jimmy Carter issued Executive Order 12073, Federal Procurement in Labor Surplus Areas, requiring set-asides for small businesses located in labor surplus areas.<sup>257</sup> Likewise, FAR Subpart 26.2 currently authorizes set-asides for small businesses located in federally directed disaster areas. In 1983, President Ronald Reagan issued Executive Order 12432, Minority Business Enterprise Development, directing all agencies with substantial procurement or grant-

256. 15 U.S.C. § 644(g) (2006).

257. Exec. Order No. 12,073, 43 Fed. Reg. 36,873, 36,873 (Aug. 16, 1978).

making authority to promote procurement from minority business enterprises (“MBEs”).<sup>258</sup> Federal tribunals generally require that race-based preferences be narrowly tailored to further a compelling interest in remedying past discrimination by the procurement agency at issue, but permit wide discretion for preferences based on purely economic factors.<sup>259</sup>

B. *The European Approach: Sustainability and Nondiscrimination as Elements of Best Value*

In Europe, economic sustainability and remedial considerations have been taken into account on a contract-by-contract basis. Further, while there are no EU-side small business categories, such categories exist at the Member State level.

The *Small Business Concordat: Good Practice Guidance* (“*Concordat*”), published by the Office of the U.K. Deputy Prime Minister in March 2005, provides a good example of a European government that has emphasized economic sustainability in local procurements.<sup>260</sup> The *Concordat* is an attempt to guide local government procurements towards integrating socioeconomic considerations into the concept of best value for money, which is required by law and which balances “economy, efficiency, and effectiveness.”<sup>261</sup> As explained by the Deputy Prime Minister’s Office:

[T]he Government’s definition of best value is the “optimum combination of whole life costs and benefits to meet the customer’s requirement.” This approach enables sustainability and quality to be taken into account when service delivery options are being considered. For example, the consideration of whole life costs allows factors such as fuel efficiency and replacement cycles to be taken into account, as well as social (e.g. benefits to local people, good workforce management, community safety, diversity and fairness). Successful procurement strategies are likely to be based on whole life cycle cost considerations that include subsequent revenue implications, and not simply the lowest initial tender price.<sup>262</sup>

The *Concordat* highlighted a contract clause that imposed the responsibility to contribute to “economic and social regeneration of the locality” in which the service will be performed.<sup>263</sup> The *Concordat* also highlighted the European procurement principles; the Local Government Act of 2000, which provided for general powers to English and Welsh authorities to promote “economic,

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258. Exec. Order No. 12,432, 48 Fed. Reg. 32,551, 32,551 (July 14, 1983).

259. *Compare* *Rothe Dev. Corp. v. Dep’t of Def.*, 545 F.3d 1023, 1049 (Fed. Cir. 2008) (invalidating race-based preferences in defense contracting for lack of evidence of past discrimination in the legislative record), *with* *AshBritt Inc., B-297889 et al.*, 2006 CPD ¶ 48 (Comp. Gen. Mar. 20, 2006) (validating state-specific local preferences for disaster recovery contracting).

260. See U.K. OFFICE OF THE DEPUTY PRIME MINISTER, *SMALL BUSINESS CONCORDAT: GOOD PRACTICE GUIDANCE* 7, 13 (Mar. 2005), available at <http://www.communities.gov.uk/documents/localgovernment/pdf/135262.pdf>.

261. *Id.*

262. *Id.* at 13.

263. *Id.*

social, and environmental well-being”; and the Race Relations (Amendment) Act of 2000, which called for “the need to eliminate unlawful racial discrimination, and to promote equality of opportunity and good relations between people from different racial groups.”<sup>264</sup>

In the United Kingdom, remedial and sustainability criteria are also part of the procurement system at the national level. For example, the 2006 *Social Issues in Purchasing Guide* (“*Social Issues Guide*”) of the U.K. Office of Government Commerce directs procurement officials to make the procurement process accessible to SMEs, including social enterprises (“SEs”), black and minority ethnic enterprises (“BMEs”), women’s and disabled-owned businesses, and the voluntary and community sector (“VCS”).<sup>265</sup> The *Social Issues Guide* also approves the use of procurement selection criteria related to hiring of the unemployed as consistent with the EC Treaty.<sup>266</sup> The *Social Issues Guide* states that the EC will not disapprove of such criteria provided there is no requirement that the unemployed be from a certain area or be registered in national labor agencies.<sup>267</sup> The *Social Issues Guide* also indicates that the European Court of Justice will sustain such criteria provided they do not discriminate against suppliers from across Europe in violation of the freedom to provide services and the right of establishment.<sup>268</sup>

The *Social Issues Guide* indicates that socioeconomic criteria may be used as requirements incidental to a contract objective,<sup>269</sup> as core requirements of a contract,<sup>270</sup> or as award criteria in cases of equal bids.<sup>271</sup> However, procedures to protect the application of these criteria from fraud or abuse appear to be lacking.

Recently, the EC again encouraged the use of public procurement for remedial and sustainability purposes. Section 46 of the EC Procurement Directive 2004/18/EC authorizes the use of broad socioeconomic criteria as part of “the most economically advantageous tender” procurements awarded on the basis of “best value for money.” The use of socioeconomic criteria must be justified:

If these conditions are fulfilled, economic and qualitative criteria for the award of the contract, such as meeting environmental requirements, may enable the contracting authority to meet the needs of the public concerned, as expressed in the specifications of the contract. Under the same conditions, a contracting authority may use criteria aiming to meet social requirements, in response in particular to the needs—defined in the specifications of the tract—of particularly disadvantaged

264. *Id.* at 13–14.

265. U.K. OFFICE OF GOV’T COMMERCE, SOCIAL ISSUES IN PURCHASING 9 (Feb. 2006), available at [http://www.ogc.gov.uk/documents/Social\\_Issues\\_in\\_Purchasing.pdf](http://www.ogc.gov.uk/documents/Social_Issues_in_Purchasing.pdf).

266. *Id.* at 26, 32.

267. *Id.* at 32.

268. *Id.* at 26, 32 (citing Case C-225-98, *Comm’n v. Fr. Republic (Nord Pas de Calais)*, 2000 E.C.R. I-07445 (authorizing effective contract preferences for SMEs hiring the unemployed)).

269. *See id.* at 11.

270. *Id.* at 15.

271. *Id.* at 27. *See generally id.* at 34–41.

groups of people to which those receiving/using the works, supplies or services which are the object of the contract belong.<sup>272</sup>

### C. Comparison

It appears that the European and the U.S. procurement systems have been used to advance similar socioeconomic goals and objectives such as redressing discrimination against women and minorities, or promoting economic development in distressed areas. Nonetheless, the U.S. system provides clear systemwide criteria for remedial contracting, while the European system contemplates wide discretion by procurement authorities. As a result, the U.S. system appears to be comparatively easier to use by contractors, easier to administer by government agencies, and less likely to be abused by unscrupulous companies misrepresenting their status. The clarity of standards in the U.S. system also helps target remedial assistance to victims of past discrimination while reducing the potential for reverse discrimination. Consideration of sustainability in individual procurement is a task that requires additional administrative resources and creates the potential for greater *ad hoc* variations or abuse in the conduct of individual procurements.

## VIII. MEASURES TO ENHANCE TRANSPARENCY AND AVAILABILITY OF PUBLIC PROCUREMENT INFORMATION FOR SMALL FIRMS

One other key procurement issue for small businesses everywhere has been the transparency and availability of information about government contract opportunities. Here, again, the European and the U.S. systems appear to be developing largely along the same lines.

### A. The U.S. Approach: Maximum Opportunity by Law

Studies conducted in the mid-twentieth century by Congress, especially by the Senate Small Business Committee, found that “small firms have difficulty in securing adequate information on proposed procurements or in securing specifications and bid seats.”<sup>273</sup> Congressional leadership insisted that contracting agencies “must provide small firms with every opportunity to be placed on bidders’ lists or to have their products placed on qualified products lists.”<sup>274</sup> In particular, the Senate Small Business Committee expressed doubt that agency “negotiated procurements” provide for full competition, and “continually recommended that negotiation be reduced in as many instances as possible and that advertised procurement become the rule rather than the exception.”<sup>275</sup>

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272. Public Procurement Directive, *supra* note 48, at recital 46.

273. Saltonstall Lecture, *supra* note 81, at 5.

274. *Id.*

275. *Id.*

In the United States, Congress and the executive branch included in federal law and regulations numerous legally binding provisions ensuring maximum practicable opportunity for small firms. These requirements cover issues such as forecasting;<sup>276</sup> publication and notice requirements;<sup>277</sup> regulatory counseling;<sup>278</sup> interagency cooperation with the SBA;<sup>279</sup> time extensions;<sup>280</sup> uniformity in legal rules, studies, and evaluations;<sup>281</sup> determinations of competency or responsibility;<sup>282</sup> surety bond guarantees;<sup>283</sup> and obligations of procurement officials to justify restrictive practices that exclude small contractors.<sup>284</sup>

For example, section 8 of the Small Business Act requires federal agencies with over \$50 million in reported contracts to publish annual forecasts of all procurement opportunities by number, anticipated dollar values, time of issuance, and responsible activity.<sup>285</sup> Section 8 of the Small Business Act further imposes requirements to electronically publicize notices of contract opportunities over \$25,000 on a government-wide portal and to publicly post notices of lesser opportunities.<sup>286</sup> The United States implemented uniform government-wide electronic advertising of contracts at one centralized point of entry, [www.FedBizOpps.gov](http://www.FedBizOpps.gov).<sup>287</sup> The United States also requires electronic registration of its contractors in order to expedite evaluations and payments;<sup>288</sup> and it merged Pro-Net, the registration database for small businesses interested in bidding for government contracts, into the general Central Contractor Registration database.<sup>289</sup> In order to assist small businesses with obtaining contracts, FAR Part 5 established a uniform policy for public advertising of federal contracts above the micro-purchase threshold across all federal agencies (with the notable exception of task orders under the indefinite delivery/indefinite quantity contracts).<sup>290</sup> FAR Part 5 also requires that solicitations provide adequate citations to laws and regulations that are binding on small business contractors.<sup>291</sup>

276. See 15 U.S.C. § 637(a)(12) (2006).

277. See FAR 5.1, 5.2.

278. See, e.g., 15 U.S.C. §§ 634b–634c; FAR 19.202-4(c).

279. See FAR 19.4.

280. See FAR 19.202-1.

281. See 15 U.S.C. §§ 405, 405a.

282. See 13 C.F.R. § 125.5 (2010); FAR 19.6.

283. See 13 C.F.R. § 115; FAR 28.2.

284. See 13 C.F.R. § 125.5; FAR 19.2.

285. 15 U.S.C. § 637(a)(12) (requiring agencies to make forecasts available to small businesses, the SBA, and agency OSDDBU offices). Agencies typically make these forecasts available on the Internet. See, e.g., *Acquisition Forecast*, U.S. DEP'T OF ENERGY, [http://diversity.doe.gov/business/acquisition\\_forecast.htm](http://diversity.doe.gov/business/acquisition_forecast.htm) (last visited Feb. 23, 2010).

286. See 15 U.S.C. § 637(e); FAR 5.101.

287. See FAR 5.1–5.3.

288. See FAR 4.11.

289. See *SBA, OMB, GSA, and DOD Work Together to Integrate Pro-Net and CCR Database and Simplify Contracting Process for Small Businesses*, U.S. SMALL BUS. ASS'N, <http://web.sba.gov/pro-net/docrootpages/index.html> (last modified Aug. 13, 2004).

290. See FAR 5.101.

291. See FAR 5.102.

FAR Subpart 19.2 sets forth further specific transparency and fairness policies to assist small businesses. FAR 19.202-2 requires government agencies to “make every reasonable effort to find additional small business concerns” before issuing solicitations.<sup>292</sup> Among other things, FAR 19.202-4 directs agencies to encourage “maximum response” to solicitation from small business concerns by allowing “the maximum amount of time practicable for the submission of offers”; providing specifications, drawings, or related information; and providing points of contact within federal agencies on contract-specific issues.<sup>293</sup> FAR 19.202-1 requires agencies to “[e]nsure that delivery schedules are established on a realistic basis that will encourage small business participation to the extent consistent with the actual requirements of the government.”<sup>294</sup> Further, FAR Part 19 also references a number of procurement assistance programs overseen by the SBA.<sup>295</sup> To assist small contractors with their financial capacity, the SBA operates a surety bond guarantee program. FAR 19.202-1 requires agencies to divide contracts in order to ensure that every small contractor’s work can be guaranteed by the SBA through the surety bond program.<sup>296</sup> The SBA Prime Contracting Assistance Regulations echo many of these requirements and further impose on agencies the obligations to cooperate with the SBA in attainment of maximum practicable participation by small businesses.<sup>297</sup> The SBA may stop noncompliant acquisitions and appeal them to heads of relevant agencies.<sup>298</sup>

Further, the SBA’s Certificate of Competency (“COC”) Program provides fair and independent evaluations of small firms who may be discriminated against because they are small. Per section 8 of the Small Business Act, the SBA is responsible for certifying to procurement agencies “all elements of responsibility, including but not limited to, capability, competency, capacity, credit, integrity, perseverance, and tenacity, of any small business concern or group of such concerns to receive and perform a specific Government contract.”<sup>299</sup> Government agencies are prohibited from passing over small businesses for award on any such grounds without referral to the SBA, and these agencies must accept SBA Certificates of Competency as conclusive.<sup>300</sup> Congress found that independent determinations of competency and responsibility through the SBA’s COC Program and its predecessor, the Small Defense Plants Corporation capability certification authority, are necessary

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292. FAR 19.202-2.

293. FAR 19.202-4.

294. FAR 19.202-1.

295. See, e.g., John R. Tolle, *Small Business Contracting (Pts. 1–2)*, BRIEFING PAPERS, Oct. 1999, at 1, BRIEFING PAPERS, Nov. 1999, at 1.

296. See 13 C.F.R. § 115 (2010).

297. See *id.* § 125.2 (2010).

298. See *id.* § 125.2(b)(7); FAR 19.4.

299. 15 U.S.C. § 637(b)(7)(A) (2006).

300. See *id.* § 637(b)(7)(C); 13 C.F.R. § 125.5; FAR 19.602-4(b) (2005).

to ensure not only fair consideration but also fair share of government contracts for small firms.<sup>301</sup> Small businesses are exposed to prime contracting and subcontracting opportunities through the business matchmaking and procurement technical assistance counseling programs of the SBA authorized under section 8 of the Small Business Act.<sup>302</sup> In 1983, Congress passed the Office of Federal Procurement Policy Act, which directed the White House to issue a uniform Federal Acquisition Regulation with due regard for impact on small business concerns and with special procedures pertaining to small business concerns.<sup>303</sup> In addition, government-wide and agency procurement regulations are reviewed by the SBA for their impact on small businesses.<sup>304</sup> To promote regulations favorable to small firms, Congress established within the SBA an independent office of the Chief Counsel for Advocacy.<sup>305</sup> These efforts resulted in synchronizing rules, reductions in regulatory burdens, and improvements of transparency in government procurement as well as in other aspects of government operations. Overall, the U.S. measures on transparency, fairness, and regulatory relief for small contractors are well-established.

### B. *The European Approach: Opportunity by Guidance*

In Europe, according to the 2004 EIM study prepared for the EC Directorate General of Enterprise and Industry, *The Access of SMEs to Public Procurement Contracts*, varying regulations and paperwork requirements for public contracts continue to present a major obstacle to successful participation of small business in government contracting.<sup>306</sup> EIM noted the need for increased education about procurement procedures, the need for greater use of e-procurement, and the need to provide fuller information.<sup>307</sup> Even among SMEs that are successful in public procurement, around thirty percent of those surveyed in the EIM study do not feel they are properly informed about procurement opportunities.<sup>308</sup>

Publication of business opportunities appears to be the biggest challenge for European small firms, especially those new to the government contracting market. In accordance with the guidance of the EC, the “Tenders Electronic Daily” (“TED”) provides a centralized electronic advertising source for procurements above the Europe-wide monetary thresholds that are required to be published in the “Supplement to the Official Journal of the European

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301. See *Siller Bros., Inc. v. United States*, 655 F.2d 1039, 1043–44 (Ct. Cl. 1981) (describing the legislative history of the Certificate of Competency program), *cert. denied*, 456 U.S. 925 (1982).

302. See 15 U.S.C. § 636(j).

303. See *id.* § 405a.

304. See *id.* § 637(a).

305. See *id.* § 634a.

306. See EIM FINAL REPORT, *supra* note 37, at 94.

307. *Id.* at 6.

308. *Id.* at 92.

Union.<sup>309</sup> However, authorities such as the U.K. Small Business Service and Office of Government Commerce acknowledged that procurements below these thresholds may be subject to a wide variety of advertising methods, and that small firms must be skilled in tapping into these resources in order to access government contracts.<sup>310</sup>

The EC has addressed these concerns in its European Code of Best Practices.<sup>311</sup> Among other things, the Code makes recommendations on SME assistance practices such as ensuring access to information, improvements in quality and understanding of procurement information, proportionality in qualifications and financial requirements, alleviation of administrative burdens, and affording SMEs sufficient time to prepare tenders.<sup>312</sup> The European Code of Best Practices encouraged European nations to develop single, nationwide procurement portals containing contract documents, as was already done in Estonia, Latvia, and Lithuania.<sup>313</sup> Electronic tendering facilities are also encouraged.<sup>314</sup> With regards to accessing and understanding procurement information, the Code recommended personalized assistance, information centers, and training programs for SMEs.<sup>315</sup> In addition, the Code emphasized obligations to provide feedback to tenderers as required by the Public Procurement Directives.<sup>316</sup> Finally, the Code called for financing and qualification requirements that would not unduly exclude SMEs.<sup>317</sup>

### C. Comparison

Traditionally, the United States has been the leader in providing transparency, publicity, fair evaluations of competency, and other types of regulatory relief and assistance to small businesses. Continuous leadership of the United States on these issues is, in large measure, ensured by their legally binding nature. However, these types of assistance are not presently central to the U.S. procurement system. Instead, their importance has been eclipsed by the emphasis on goals and set-asides. In contrast, European Member States appear to strongly emphasize regulatory relief-type measures as a major element of procurement assistance for their SMEs. The obvious weakness with these European efforts in this area is that they are largely advisory, and there is no

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309. See TED—TENDERS ELECTRONIC DAILY, [http://ted.europa.eu/Exec?Template=TED/editorial\\_page.htm&DataFlow=ShowPage.dfl&StatLang=EN](http://ted.europa.eu/Exec?Template=TED/editorial_page.htm&DataFlow=ShowPage.dfl&StatLang=EN) (last visited Feb. 19, 2010).

310. U.K. TENDERING GUIDE, *supra* note 42, at 3.

311. *Eur. Code of SME Best Practices*, *supra* note 12, at 10–11.

312. See *id.* at 10–20.

313. *Id.* at 11 (“In Latvia, all public tender notices are published on a single web portal which is accessible free of charge and offers daily news service. In Estonia, there is a single online public procurement register for all contract notices which is the sole medium for publishing at national level. Lithuania also uses a single web portal for all contract notices; this offers the possibility for multi-criteria search as well as user interfaces available in Lithuanian and English.”).

314. *Id.* at 11.

315. *Id.* at 12–13.

316. *Id.* at 12.

317. *Id.* at 14.

obvious mechanism to enforce them for the benefit of specific contractors beyond political mechanisms of the EC and Member State governments.

#### IX. SUBCONTRACTING GOALS, GUARANTEES, AND INCENTIVES

Both the United States and Europe have adopted policies and practices to promote subcontracting by small businesses with large firms. However, in this area, the European authorities have led the way in requiring meaningful subcontracting participation, while authorities in the United States have attempted to follow the approach used in Europe on a case-by-case basis.

##### A. *The U.S. Approach: Nonbinding Assistance Measures*

As early as the 1950s, congressional leadership held the view that “everything possible [should] be done to encourage subcontracting to small business concerns” with regard to “a weapons system concept of procurement.”<sup>318</sup> This sentiment found its way into the Small Business Act, which contains provisions identifying subcontracting goals for various small business categories<sup>319</sup> and directing the prime contractors to

establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women.<sup>320</sup>

Section 8 of the Small Business Act also directs most large prime contractors to include a clause promising small businesses maximum practicable opportunity for participation in subcontracts.<sup>321</sup> Further, section 8 authorizes agencies to offer incentives for subcontracting to small firms.<sup>322</sup> FAR 19.708 also authorizes agencies to provide incentive fees and use small business sub-

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318. Saltonstall Lecture, *supra* note 81, at 5–6.

319. 15 U.S.C. § 644 (2006).

320. *Id.* § 637(d).

321. *Id.*

322. The incentive authority in 15 U.S.C. § 637(d)(4)(E) provides:

Notwithstanding any other provision of law, every Federal agency, in order to encourage subcontracting opportunities for small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, and small business concerns owned and controlled by the socially and economically disadvantaged individuals as defined in paragraph (3) of this subsection and for small business concerns owned and controlled by women, is hereby authorized to provide such incentives as such Federal agency may deem appropriate in order to encourage such subcontracting opportunities as may be commensurate with the efficient and economical performance of the contract: Provided, That, this subparagraph shall apply only to contracts let pursuant to the negotiated method of procurement.

contracting as award evaluation criteria.<sup>323</sup> Some agencies responded to these authorities by creating formal mentor-protégé programs, which give large businesses various incentives (such as proposal evaluation credits during competitions or the ability to count assistance costs towards subcontracting goals during contract performance) to help small firms build capacity.<sup>324</sup>

Further, section 8 of the Small Business Act, as implemented by FAR Subpart 19.7, generally requires companies that receive federal contracts over \$500,000 for products or services and over \$1 million for construction to prepare small business subcontracting plans.<sup>325</sup> These plans are to be based on market research, and are to contain agreed-upon goals for participation of various small business categories. The Small Business Act further provides that companies that do not conclude such plans within the time required by the agency will be denied the contract.<sup>326</sup>

The goals for small business participation set forth in these subcontracting plans, however, are not legally binding. The reason is that the Act penalizes only those prime contractors that fail to comply with the plan requirements in “good faith.”<sup>327</sup> As long as a prime contractor can demonstrate that it conducted outreach to potential small business subcontractors, noncompliance with the goals will be excused under this “good faith” standard. In theory, the

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323. FAR 19.708.

324. See, e.g., *Mentor-Protégé Program*, U.S. DEP'T OF HOMELAND SECURITY, [http://www.dhs.gov/xopnbiz/smallbusiness/editorial\\_0716.shtml](http://www.dhs.gov/xopnbiz/smallbusiness/editorial_0716.shtml) (last modified July 1, 2010).

325. See FAR 19.7.

326. See 15 U.S.C. § 637(d)(4)(B)–(D), which provides:

(B) Before the award of any contract to be let, or any amendment or modification to any contract let, by any Federal agency which—(i) is to be awarded, or was let, pursuant to the negotiated method of procurement, (ii) is required to include the clause stated in paragraph (3), (iii) may exceed \$1,000,000 in the case of a contract for the construction of any public facility, or \$500,000 in the case of all other contracts, and (iv) which offers subcontracting possibilities, the apparent successful offeror shall negotiate with the procurement authority a subcontracting plan which incorporates the information prescribed in paragraph (6). The subcontracting plan shall be included in and made a material part of the contract. (C) If, within the time limit prescribed in regulations of the Federal agency concerned, the apparent successful offeror fails to negotiate the subcontracting plan required by this paragraph, such offeror shall become ineligible to be awarded the contract. Prior compliance of the offeror with other such subcontracting plans shall be considered by the Federal agency in determining the responsibility of that offeror for the award of the contract. (D) No contract shall be awarded to any offeror unless the procurement authority determines that the plan to be negotiated by the offeror pursuant to this paragraph provides the maximum practicable opportunity for small business concerns, qualified HUBZone small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women to participate in the performance of the contract.

327. See *id.* § 637(d)(4)(F)(ii) (“The contractor shall be afforded an opportunity to demonstrate a good faith effort regarding compliance prior to the contracting officer’s final decision regarding the imposition of damages and the amount thereof. The final decision of a contracting officer regarding the contractor’s obligation to pay such damages, or the amounts thereof, shall be subject to the Contract Disputes Act of 1978 (41 U.S.C. §§ 601–613)).”).

penalty for noncompliance includes assessment of liquidated damages.<sup>328</sup> In practice, such assessments are virtually unknown.

The SBA has traditionally assigned a forty percent government-wide small business subcontracting goal.<sup>329</sup> According to the SBA data, small businesses received only between thirty-five and thirty-six percent of total subcontracts awarded by large prime contractors on federal contracts during fiscal years 2006 and 2007, and the small business subcontracting share drastically decreased to less than twenty-nine percent in fiscal year 2008.<sup>330</sup>

Subcontracting policy in the United States is very unsettled at the present time. In 2005, the U.S. Government Accountability Office recommended that agencies should evaluate small business subcontracting based on percentage of total contract value in order to promote integrity, accountability, and meaningful small business participation.<sup>331</sup> This method is gaining popularity with federal agencies, as it enables agencies to impose mandatory subcontracting obligations on large businesses.<sup>332</sup> The recently passed Small Business Jobs Act of 2010 requires large prime contractors to account in writing to the contracting agency if the primes fail to subcontract with small firms to the extent listed in the proposal, and provides for adverse past performance ratings if primes fail to pay small business subcontractors on time or without justification.<sup>333</sup> Further, the GAO recently issued an advisory opinion that interprets the Small Business Act to allow for zero small business participation in subcontracting plans at the first tier of subcontracting.<sup>334</sup> Thus, there is a strong possibility that allowing large firms to allot small firms a share

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328. *Id.*

329. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-459, DEPARTMENT OF ENERGY: IMPROVED OVERSIGHT COULD BETTER ENSURE OPPORTUNITIES FOR SMALL BUSINESS SUBCONTRACTING 6 (2005).

330. U.S. SMALL BUS. ADMIN., FEDERAL FY2008 PROCUREMENT SUBCONTRACTING REPORT (2009), available at [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/fy2008\\_pro\\_subcontracting\\_rep.pdf](http://www.sba.gov/idc/groups/public/documents/sba_homepage/fy2008_pro_subcontracting_rep.pdf); *Sub-contracting Goals and Reports*, U.S. SMALL BUS. ADMIN., [http://www.sba.gov/aboutsba/sbaprograms/goals/SBGR\\_2006\\_SCGR.html](http://www.sba.gov/aboutsba/sbaprograms/goals/SBGR_2006_SCGR.html) (last visited Feb. 23, 2010) (linking to subcontracting reports for fiscal years 2004 through 2007). Historically, however, small businesses have received close to forty percent of total subcontracted dollars government-wide. See OFFICE OF ADVOCACY, U.S. SMALL BUS. ADMIN., REPORT NO. 281, THE GOVERNMENT'S ROLE IN AIDING SMALL BUSINESS FEDERAL SUBCONTRACTING PROGRAMS IN THE UNITED STATES 1, 3 (2006), available at <http://www.sba.gov/advo/research/rs281tot.pdf>.

331. See IMPROVED OVERSIGHT COULD BETTER ENSURE OPPORTUNITIES FOR SMALL BUSINESS SUBCONTRACTING, *supra* note 329, at 27.

332. See, e.g., Nova Builders, B-402091 et al., 2010 CPD ¶ 33, at 13-14 (Comp. Gen. Jan. 19, 2010) (mandatory subcontracting obligations imposed by the U.S. Department of Veterans Affairs); see also Press Release, Sen. Olympia Snowe, Energy Department to Comply with Small Business Act's Subcontracting Rules (June 20, 2005) (announcing the Department of Energy's agreement to follow subcontracting measurement recommendations in the Improved Subcontracting Oversight Report, GAO-05-459).

333. See Small Business Jobs Act of 2010, Pub. L. No. 111-240, §§ 1322, 1334, 124 Stat. 2504, 2541-42.

334. See Northrop Grumman Space & Missile Sys. Corp., B-400837 et al., 2009 CPD ¶ 52, at 16 (Comp. Gen. Feb. 17, 2009).

of zero subcontracts at the first tier would render the Small Business Act's subcontracting provisions meaningless regardless of whether subcontracting obligations are considered to be mandatory or merely "good faith."

B. *The European Approach:  
Binding Assistance Measures*

European efforts to promote subcontracting have traditionally focused on improving access to information about subcontracts. It appears that this approach is being increasingly phased out in favor of requiring prime contractors to comply with mandatory subcontracting obligations. Traditionally, it seems that Europeans have avoided mandatory subcontracting obligations in their national procurements. As the British Government noted in 2004, "[t]here is no single way of finding out about subcontracting opportunities, although OGC is encouraging large suppliers to government to make subcontracting opportunities available via their websites."<sup>335</sup>

However, there is also a strong European precedent for mandatory subcontracting set-asides. For instance, the European Space Agency uses the so-called C1 and C3 clauses, which reserve certain subcontracts to non-prime contractors and SMEs.<sup>336</sup> Non-primers do not include large systems integrators dominating European aerospace industry such as EADS and Alcatel-Alenia Space.<sup>337</sup> According to the ESA SME Policy Office, the C1 Clause reserves subcontracting opportunities to "equipment suppliers and SMEs," while the C3 Clause reserves these opportunities to "SMEs and Research Institutes."<sup>338</sup> ESA "[p]rocurements where the C1 and C3 clauses are used include those for technology research activities and for the development of equipment, components, or instruments—where SMEs and their partners have the necessary expertise, and there favoring these entities would result in a more efficient use of funds."<sup>339</sup> The ESA also uses the C2 Clause for non-primers and SMEs and the C4 Clause for SMEs on procurements over €250,000.<sup>340</sup> These clauses request large primes to provide for adequate participation of SMEs in terms of quality and quantity, or to justify why such adequate participation cannot be achieved.<sup>341</sup>

The European Commission's support for mandatory SME subcontracting obligations is over two decades old.<sup>342</sup> Recently, the EC again gave its strong

335. U.K. TENDERING GUIDE, *supra* note 42, at 5.

336. *Procurement Policy on Fair Access for SMEs—the C1–C4 Clauses*, EUR. SPACE AGENCY, [http://www.esa.int/esaMI/Business\\_Opportunities/SEMECJ0CYTE\\_0.html](http://www.esa.int/esaMI/Business_Opportunities/SEMECJ0CYTE_0.html) (last visited Dec. 1, 2010).

337. *Id.*

338. *Id.*

339. *Id.*

340. *Id.*

341. *Id.*

342. See EC, *Communication to the Council: Promoting SME Participation in Public Procurement in the Community*, COM (90) 166 final (May 7, 1990), available at [http://aei.pitt.edu/3708/01/000269\\_1.pdf](http://aei.pitt.edu/3708/01/000269_1.pdf); EC, *Communication from the Commission: Development of Subcontracting in the Community*, COM (89) 402 final (Aug. 7, 1989), available at [http://aei.pitt.edu/3761/01/000244\\_1.pdf](http://aei.pitt.edu/3761/01/000244_1.pdf).

endorsement to mandatory subcontracting set-asides. To that end, article 21(4) of the Defense Procurement Directive clearly states:

Member States may provide that the contracting authority/entity may ask or be required to ask the successful tenderer to subcontract to third parties a share of the contract. The contracting authority/entity that imposes such subcontracting shall express this minimal percentage in the form of a range of values, comprising a minimum and a maximum percentage. The maximum percent may not exceed thirty percent of the value of the contract. Such a range shall be proportionate to the object and the value of the contract, and the nature of the industry sector involved, including the level of competition in that market and the relevant technical capabilities of the industrial base.<sup>343</sup>

Recital (3) and article 73 of the Directive indicate that the Directive is designed to promote SME participation in the industrial base.<sup>344</sup> The mandatory minimum operates essentially as a subcontracting set-aside required of prime contractors. Article 20 of the Defense Procurement Directive also approves the use of subcontracting, including subcontracting driven by social consideration, as conditions of contract performance.<sup>345</sup>

Substantially similar language is found in the 2004/18/EC Public Procurement Directive.<sup>346</sup> Indeed, the Public Procurement Directive also expressly states that “[i]n order to encourage the involvement of small and medium-sized undertakings in the public contracts procurement market, it is advisable to include provisions on subcontracting.”<sup>347</sup> These provisions would, in all likelihood, closely resemble the mandatory minimums approved in the Defense Procurement Directive.

At the same time, the Europeans also treat subcontracting with SMEs as award criteria. Section 1.4 of the European Code of Best Practices states that “contracting authorities are encouraged to ask their main suppliers to demonstrate their track record in achieving value for money through the effective use of their supply chain, including how SMEs can gain access to their subcontracting opportunities.”<sup>348</sup> The European Code of Best Practices also emphasizes national practices such as publication of subcontracting opportunities and legal measures to discourage subcontracting terms that are less favorable than the prime contractor’s terms with the Government.<sup>349</sup> Similar guidance is given in the European Defense Agency’s Code of Best Practices

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343. Defense Procurement Directive, *supra* note 49, art. 21(4). The Defense Procurement Directive language authorizing mandatory SME subcontracting obligations appears to be a means of ensuring “meaningful” participation of European Member States with a large concentration of SME defense firms without reliance on the principle of *juste retour*. Cf. *EDA Code of Conduct*, *supra* note 67, at 56–57 (describing the need to ensure “meaningful” participation of national SME defense suppliers).

344. Defense Procurement Directive, *supra* note 49, art. 3(73).

345. *Id.* art. 20.

346. See Public Procurement Directive, *supra* note 48, at recitals 1, 46 & art. 26.

347. *Id.* at 32.

348. *Eur. Code of SME Best Practices*, *supra* note 12, at 10.

349. See *id.* at 10.

in the Supply Chain.<sup>350</sup> The EDA further recognizes offsets, including subcontracting requirements to local industry, as one of the best-value award selection criteria.<sup>351</sup>

### C. Comparison

Subcontracting policies in Europe and the United States are the mirror images of their own policies on prime contracting for SMEs. In Europe, government agencies drive the awards of subcontracts to SMEs in a way that looks very much like legally binding reservations and set-asides at the prime contracting level in the United States. In the United States, on the other hand, subcontract awards to small firms have been promoted largely through “good faith”-based subcontracting plans. Clearly, the European approach will bring more accountability to subcontracting if adopted in the United States. At the same time, the European subcontracting policy of mandatory set-aside minimums demonstrates that Europeans are not as opposed to SME set-asides in principle as the European trade-related complaints about U.S. set-asides may suggest.

## X. USE OF PUBLIC PROCUREMENT TO STIMULATE SMALL BUSINESS INNOVATION

Innovation is one area in which there appears to be a remarkable convergence in small business procurement policy between Europe and the United States. While the United States exhibited early policy leadership in this area, European states are quickly following suit.

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350. Specifically, the Code of Best Practices in the Supply Chain provides:

In assessing what is economically advantageous in the selection of Suppliers, it shall be taken into consideration that both Buyers and Suppliers need to take strategic sourcing decisions that are wider than individual contract or programme requirements. . . . In evaluating tenders of Suppliers, buyers will consider, amongst other things, the approach undertaken or proposed for the selection of sources of supply (including, where appropriate, make or buy plans), having regard to the principles of the CoBPSC. . . . Monitoring arrangements will be introduced to assess the extent to which the CoBPSC is being applied. It will be based on Prime Contractors providing information on sub-contract opportunities advertised.

CoBPSC, *supra* note 71, at 4.

351. See *Code of Conduct on Defence Procurement*, EUR. DEF. AGENCY (last updated Mar. 5, 2007), <http://www.eda.europa.eu/genericitem.aspx?area=Organisation&cid=154> (“The fundamental criterion for the selection of the contractor will be the most economically advantageous solution for the particular requirement, taking into account inter alia considerations of costs (both acquisition and life cycle), compliance, quality and security of supply and offsets.”). The European Commission defined offsets on defense purchases as follows: “This allows the purchasing country to require a return on investment that may exceed 100% of the value of the contract. Such offsets may be direct, in the form of orders for local companies or transfers of know-how and technology related to the original contract. Offsets may also be indirect and concern industrial sectors other than the one covered by the contract in question, even non-military ones.” EC, *Green Paper on Defence Procurement*, at 5, COM (2004) 608 final (Sept. 23, 2004), available at [http://eur-lex.europa.eu/LexUriServ/site/en/com/2004/com2004\\_0608en01.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/com/2004/com2004_0608en01.pdf).

### A. *The U.S. Approach: Leading on Pro-innovation Set-Asides*

In 1982, responding to President Ronald Reagan's request, the U.S. Congress passed the Small Business Innovation Development Act, which established the Small Business Innovation Research Program ("SBIR").<sup>352</sup> According to President Reagan, "[t]he Small Business Innovation Development Act recognizes that we in government must work in partnership with small business to ensure that technologies and processes are readily transferred to commercial application."<sup>353</sup> Ten years later, in 1992, Congress passed legislation to create a supporting program, the Small Business Technology Transfer Program ("STTR").<sup>354</sup> Both programs are codified in section 9 of the Small Business Act, which is implemented in the SBA's SBIR and STTR Policy Directives.<sup>355</sup> For SBIR and STTR purposes, commercialization includes sales to the Government as well as to the private sector.

In the traditional U.S. set-aside approach, the SBIR Program sets aside 2.5% of extramural research and development funds at federal agencies with over \$100 million in extramural research and development funds for awards to small business.<sup>356</sup> The STTR program applies to agencies with over \$1 billion in extramural research and development funds, and sets aside 0.3% of such funds for award to small businesses that partner with nonprofit research institutions and Federally-Funded Research and Development Centers.<sup>357</sup>

To participate in SBIR, SBA regulations require that a company must meet the 500-employee size standards and be majority-owned by individual U.S. citizens or permanent residents, or by a venture capital firm that is itself majority-owned by such persons.<sup>358</sup> To participate in the STTR program, the research institution must perform not less than thirty percent of the work and the small business must perform not less than forty percent of the work.<sup>359</sup> Three phases of awards are recognized under section 9: Phase I is used to help a small business turn an innovative idea into an innovative solution meeting

352. See 15 U.S.C. § 638 (2006).

353. President Ronald Reagan, Remarks on Signing the Small Business Innovation Development Act of 1982, 2 PUB. PAPERS 960 (July 22, 1982), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=42777>.

354. See 15 U.S.C. § 638.

355. See generally Small Business Technology Transfer Program Policy Directive, 70 Fed. Reg. 74,926-01 (Small Bus. Admin. Dec. 16, 2005) [hereinafter STTR Policy Directive], amended by 72 Fed. Reg. 23,405 (Apr. 30, 2007); Small Business Innovation Research Program, 67 Fed. Reg. 60,071 (Small Bus. Admin. Sept. 24, 2002) [hereinafter SBIR Policy Directive], amended by 72 Fed. Reg. 23,407-01 (Apr. 30, 2007). The amendments were designed to implement President George W. Bush's Exec. Order No. 13,329, Encouraging Innovation in Manufacturing, 69 Fed. Reg. 9181 (Feb. 24, 2004).

356. See 15 U.S.C. § 638.

357. See *id.*

358. Press Release, Small Bus. Admin., No. 07-69, FAQ on SBA's SBIR Program and Venture Capital Investment (Oct. 18, 2007), available at <http://www.bizgeorgia.com/News/Small-Business-Administration/SBIR%11VA/>.

359. See STTR Policy Directive, 70 Fed. Reg. at 74,925-74,931.

the Government's interests; Phase II is used to help a small business develop the commercialization of the solution; and Phase III is used for actual commercialization without the help of SBIR or STTR funds but relies on other government funding or private sector contracts.<sup>360</sup> SBIR or STTR awards may be made using grants, cooperative agreements, or contracts. SBIR and STTR programs include two rounds of competition; however, the SBIR Policy Directive clarifies that companies that received the SBIR awards at Phases I and II qualify for sole-source contracts at Phase III.<sup>361</sup> Thus, the SBIR and STTR programs are hybrids between procurement and nonprocurement funding. Within defense procurement, section 9 authorizes a special SBIR Commercialization Pilot Program (CPP) in order to accelerate transition of small business innovations into defense acquisition programs.<sup>362</sup> Some civilian agencies also have commercialization assistance programs.<sup>363</sup> The SBIR program generated tremendous return on a relatively modest investment. According to the Small Business Technology Council, SBIR companies have generated approximately twenty-five percent of the most important innovations over the last decade while large businesses generated less than five percent and universities, approximately eight percent.<sup>364</sup> However, small firms generally receive only 4.3% percent of federal R&D and the non-SBIR/STTR share of such funding has been declining.<sup>365</sup> Thus, it is clear that the SBIR program is one of the few bright spots in the federal procurement system that continues to place wasteful and inefficient R&D projects with large, entrenched contractors. However, the SBIR and STTR programs face an uncertain future. In 2008, the SBIR program was validated for reauthorization in an assessment conducted by the National Research Council of the National Academy of Sciences.<sup>366</sup> Despite endorsement of the National Academies and support among the small business community, Congress has resorted to short-term extensions for both the SBIR and the STTR programs since the

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360. See 15 U.S.C. § 638.

361. See STTR Policy Directive, 70 Fed. Reg. at 74,926-31; SBIR Policy Directive, 67 Fed. Reg. at 60,071-85.

362. See *Small Business Innovation Research*, U.S. DEP'T OF DEF., <http://www.dodsbir.net/cpp/default.htm> (last visited Oct. 1, 2010); National Defense Authorization Act for Fiscal Year 2006, Pub. L. No. 109-63, § 252, 119 Stat. 3136 (Jan. 6, 2006).

363. See, e.g., *U.S. Department of Energy Research and Technical Assistance Program (Work for Others Program)*, OAK RIDGE NAT'L LAB., <http://www.ornl.gov/adm/wfo/exthome.htm> (last visited Oct. 1, 2010); *DHS S&T SBIR Program: Cost Match Feature*, U.S. DEP'T OF HOMELAND SEC., <https://www.sbir.dhs.gov/CostMatchInfo.aspx> (last visited Feb. 25, 2010).

364. See *Roundtable on Small Business Research and Development: Before the S. Comm. on Small Bus. & Entrepreneurship*, 111th Cong. 1 (June 4, 2009) (statement of Jere Glover, Exec. Dir., Small Bus. Tech. Council), available at [http://www.nsba.biz/docs/09\\_smallbusinessr\\_d\\_testimony.pdf](http://www.nsba.biz/docs/09_smallbusinessr_d_testimony.pdf).

365. See *id.*

366. See COMM. FOR CAPITALIZING ON SCI., TECH., & INNOVATION, NAT'L ACADS., AN ASSESSMENT OF THE SBIR PROGRAM (Charles W. Wessner ed., Nat'l Acads. Press 2008), available at [http://www.nap.edu/catalog.php?record\\_id=11989#toc](http://www.nap.edu/catalog.php?record_id=11989#toc).

end of September 2009.<sup>367</sup> As of early 2010, the United States is in danger of losing these crucial innovation tools due to legislative gridlock.

### B. *The European Approach: Replicating Pro-innovation Set-Asides*

In Europe, according to another study done under the direction of the EC, “almost all countries have adopted measures to promote innovation in general, and in SMEs in particular.”<sup>368</sup> Based on the study *Innovation Policy in Europe 2004*, it appears that Europeans are deliberately augmenting the principle of equal treatment regardless of company size with the concerted policy to promote SME innovation through public procurement. In particular, the study recognizes “the intention of Sweden to mobilise demand through public procurement by the adoption of a Swedish version of the U.S. SBIR programme.”<sup>369</sup> The study also observes that “public procurement can play a major part in creating the demand for innovation,” and it noted the plan of the United Kingdom to use the “government’s purchasing power to support innovation.”<sup>370</sup>

To implement this approach, the United Kingdom established the Small Business Research Initiative (“SBRI”). As the acronym suggests, the policy model builds on that of the U.S. SBIR. The SBRI imposes a small business procurement set-aside of “at least 2.5% of [the participating Government Departments’] research and development requirements.”<sup>371</sup> The U.K. initiative also has an overall target of “£50 million of government research to be bought from smaller businesses by 2004.”<sup>372</sup> SBRI is a form of “pre-commercial procurement” based on exclusion of R&D from the EU procurement rules.<sup>373</sup> In the United Kingdom, the SBRI program is administered by the Technology Strategy Board, a stand-alone government agency funded by the Department of Business, Innovation, and Skills.<sup>374</sup> Just like the SBIR program, the SBRI

367. See National Defense Authorization Act for Fiscal Year 2010, Pub. L. No. 111-84, §§ 847–848, 123 Stat. 2190 (Oct. 28, 2009) (providing for one-year extension of Department of Defense SBIR, SBIR CPP, and STTR programs); *Congress Extends SBIR Program for 90 Days*, SMALL BUS. TECH. COUNCIL (Jan. 28, 2010), <http://www.nsba.biz/content/2832.shtml> (“This is the sixth CR [Continuing Resolution] passed since the SBIR program was originally up for expiration in 2008.”).

368. EC, *Trend Chart: Innovation Policy in Europe 2004*, at 27 (2005), available at [http://www.euroqualityfiles.net/cecistnet/FP6-FP7-portals/IST-ICT/Report/Innovation\\_policy\\_europe\\_2004.pdf](http://www.euroqualityfiles.net/cecistnet/FP6-FP7-portals/IST-ICT/Report/Innovation_policy_europe_2004.pdf).

369. *Id.*

370. *Id.* at 98.

371. U.K. TENDERING GUIDE, *supra* note 42, at 5.

372. *Id.*

373. See DEP’T FOR BUS. INNOVATION & SKILLS, U.K. OFFICE OF GOV’T COMMERCE, DRIVING INNOVATION THROUGH PUBLIC PROCUREMENT 13 (July 2009), available at [http://www.ogc.gov.uk/documents/OGC09-0679\\_InnovationBrochure.pdf](http://www.ogc.gov.uk/documents/OGC09-0679_InnovationBrochure.pdf).

374. See TECH. STRATEGY BD., SBRI 3 (2009) (U.K.), available at [http://www.innovateuk.org/\\_assets/pdf/Corporate-Publications/SBRI%20intro%20brochure.pdf](http://www.innovateuk.org/_assets/pdf/Corporate-Publications/SBRI%20intro%20brochure.pdf) (last visited Oct. 10, 2010).

program has two developmental phases and a third phase involving procurement of a finished product, technology, or service.<sup>375</sup> SBRI awards are contracts, not grants.<sup>376</sup> The SBRI Phase I program concerns feasibility of an innovation, while the SBRI Phase II concerns product development.<sup>377</sup> Phase II participants are chosen through an assessment process at the end of Phase I.<sup>378</sup> At the end of Phase II “it is intended that what has been achieved will be manufactured and purchased by the Department [which established the need for the topic] as a way of fulfilling their procurement requirements.”<sup>379</sup>

The French Government also actively promotes set-asides for innovative SMEs. In 2005, then-President Jacques Chirac included SME set-asides and preferences into his aptly titled national R&D policy announcement, *Global Competition for Technological Supremacy*:

[T]he State has a responsibility to promote an environment which is propitious for the development of major industrial projects. This implies having clear strategic priorities: a small number of substantial stimulating programs—concentrated in a small number of key technological areas. It means that everyone involved, SMEs and research laboratories, must network around major enterprises. It implies a European dimension, without which any grand industrial goal would be futile. . . . I'd also like to convey a special message here to the leaders of the top French companies. . . . Today, you must enter into a new partnership for progress with our nation. . . . [T]here's a need to bring in the small and medium-sized enterprises, which, alongside you, are making an essential and increasingly essential contribution to growth and innovation. It is up to you to involve them more closely in your research efforts and enter into strategic joint ventures with them. For its part, the State, as the leading purchaser of technology, will undertake to provide incentives: the government will submit a proposal to the European Commission on a mechanism allowing some of the work in technology-related public procurement contracts to be reserved for SMEs.<sup>380</sup>

Under President Nicholas Sarkozy, France has continued pursuing measures to promote pro-innovation SME set-asides. These measures included “raising from €133,000 to €206,000 the threshold for application of the WTO Agreement on Government Procurement,”<sup>381</sup> a fifteen percent procurement participation share for innovative SMEs,<sup>382</sup> and monitoring of government agencies for their contract awards to small innovative firms.<sup>383</sup>

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375. *See id.* at 4.

376. *See id.* at 3.

377. *See id.* at 4.

378. *See id.*

379. *SBRI FAQs*, TECH. STRATEGY BD. (U.K.), [http://www.innovateuk.org/\\_assets/pdf/sbri-faqs.pdf](http://www.innovateuk.org/_assets/pdf/sbri-faqs.pdf) (last visited Sep. 16, 2009).

380. M. Jacques Chirac, President of the Fr. Republic, Speech on Global Competition for Technological Supremacy: Setting out France's Policy on Research and Innovation (Aug. 30, 2005), <http://www.ambafrance-uk.org/Global-competition-for.html>.

381. *Excerpt from the Communiqué Issued Following the Council of Ministers' Meeting, European Action Plan for Small and Medium-Sized Enterprises*, FR. EMBASSY IN U.K. (May 14, 2008), <http://www.ambafrance-uk.org/European-action-plan-for-SMEs.html>.

382. *See* Emery, *supra* note 246.

383. *Id.*

National SBIR-style programs have also been adopted in Finland<sup>384</sup> and the Netherlands.<sup>385</sup> Even without legislation, the French and other national governments require and incentivize subcontracts with hi-tech SMEs under a quasi-official “SME Pact” program.<sup>386</sup>

In fact, the EC and other EU-level authorities have been themselves promoting SME innovation set-asides. First, the Public Procurement Directive and the so-called Lisbon Strategy (which called for spending three percent of European GDP on R&D by 2010 in order to make Europe the most competitive place in the world) encouraged national SBIR-type reforms.<sup>387</sup> Second, projects set aside for SMEs were funded as part of the EC’s Framework Programs for Research and Technological Development, as well as the EC’s Competition and Innovation Framework Program 2007–2013.<sup>388</sup> The latest list of such funding opportunities related to the Seventh Framework Program may be found in the 2008 guide published by the EC Enterprise & Industry Directorate General.<sup>389</sup> Third, the EC’s *Strategy for a Stronger and More Competitive European Defense Industry* identifies these funding opportunities as a way to stimulate the EU Defense and Technology Industrial Base, pointing out that “[s]pecific provisions have also been introduced to encourage SME participation in the Seventh Framework Program for Research . . . and through the ‘Research for the benefit of SMEs’ initiative including, raising

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384. See, e.g., *Funding and Services for Small Businesses in Finland*, NAT’L TECH. AGENCY OF FIN., <http://www.tekes.fi/en/community/Small%20businesses/548/Small%20businesses/1420> (last visited Mar. 1, 2010).

385. See generally *STRONG: Dutch SBIR Programme*, NETH. MINISTRY OF ECON. AFFAIRS, [http://www.senternovem.nl/sbir/sbir\\_in\\_the\\_netherlands.asp](http://www.senternovem.nl/sbir/sbir_in_the_netherlands.asp) (last visited Mar. 1, 2010) (announcing the Dutch Government’s intent to act as a “launching customer” for future high-tech SME suppliers with less than 100 employees).

386. A typical SME Pact program operates through agreements between large prime contractors (especially multinationals and government-owned defense firms), an SME trade association, and government contracting agencies. These allegedly voluntary agreements are directed and monitored by top national leaders, such as French President Nicholas Sarkozy. Under the SME Pact, large prime contractors are obligated to extend research, development, testing, and evaluation (RDT&E) subcontracts to innovative SMEs and to fund one-third of the total RDT&E cost (likely with flow-down procurement funds) while receiving supposedly non-procurement funds from a national SME agency for another one-third of the total RDT&E cost. See Eric Jourdain, OSEO & Comité Richelieu, *The SME Pact: Growing Together*, Presentation at INNO-Views Policy Workshop “Lead Markets and Public Procurement: Joining Up to Foster Innovation,” The Hague, Netherlands (July 3–8, 2008), available at [http://www.proinno-europe.eu/sites/default/files/2\\_3\\_WS05\\_Jourdain7913.pdf](http://www.proinno-europe.eu/sites/default/files/2_3_WS05_Jourdain7913.pdf). SMEs assisted by the French SME Pact R&D scheme can have up to €100 million in turnover and up to 1,000 employees. See Eric Jourdain, European Affairs, Comité Richelieu, *SME Pact: General Overview*, Presentation at the Turin Euro Latin American Forum: Public-Private Partnerships for Knowledge-Based Regional Development, Turin, Italy (Oct. 24–26, 2007), available at <http://www.forumtorino.org/download.php?fileID=315&lang=en>.

387. *Id.* (citing the exemption for R&D procurements from the Public Procurement Directive, *supra* note 48, art. 16(f)).

388. See, e.g., Petrou, *supra* note 63, at 150 n.48.

389. See EC, *European Union Support Programs for SMEs: An Overview of Main Funding Opportunities Available to European SMEs* (Nov. 2008), available at [http://ec.europa.eu/enterprise/entrepreneurship/docs/financing/sp\\_2008\\_en.pdf](http://ec.europa.eu/enterprise/entrepreneurship/docs/financing/sp_2008_en.pdf) (discussing R&D program cost reimbursement rules).

the maximum [project costs] reimbursement rate for SMEs from 50% to 75% and introducing simplified participation rules.<sup>390</sup>

### C. Comparison

The United States has led Europe in adopting pro-innovation small business set-asides to ensure that federal R&D funding is spent more efficiently and does not remain with the same, established contractors. In Europe today, there is a virtual consensus that this policy instrument is necessary to spur innovation and international competitiveness in the manner that is beneficial to the taxpayers and to the SME sector alike. The United States must ensure that it does not squander its international competitive leadership by failing to reauthorize or otherwise support the SBIR and STTR programs.

In terms of program administration, the U.S. SBIR program appears to be more competitive than the British SBRI program. This is because SBIR includes a separate round of competition at Phase II, which gives companies an opportunity to further improve the commercial potential of their Phase I research. Except at the Department of Defense, Phase II entry is generally not restricted by invitations. The British SBRI program contains a direct link to specific procurement programs of various government departments that were the source for research topics competed at Phases I and II. The U.S. SBIR program, save for the Department of Defense Commercialization Pilot Program, does not appear to have such a strong built-in link. This may in part account for the fact that SBIR traditionally funded R&D, which also can be commercialized in the private sector and not merely through government procurement. When combined with the SME Pact, SBRI can become a strong alternative policy model to SBIR.

## XI. CONCLUSION: IMPLICATIONS FOR TRANSATLANTIC PROCUREMENT REFORMS, U.S. INDUSTRIAL BASE AND INNOVATION POLICIES, AND U.S.-EUROPEAN TRADE

The United States has historically led the way in encouraging the development and growth of small business through public procurement and has reaped substantial socioeconomic benefits such as a more competitive industrial base for civilian and defense needs, stronger innovation, and greater economic opportunity. In recent years, the European Union, many of its Member States, and European agencies have sought to vigorously use public procurement in order to achieve similar results in their procurement systems and economies.

Based on this assessment, policies largely in common across the Atlantic include pro-innovation set-asides, good government and regulatory relief

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390. EC, *Strategy for a Stronger and More Competitive European Defense Industry*, at recital 3.2.3, COM (2007) 764 final (May 12, 2007), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0764:FIN:EN:PDF>.

measures, and pro-competitive measures to reduce contract consolidation. The two sides also begin to share common approaches to prime contracting set-asides, goals, and reservations as Europe is expanding these measures across the board. Europe, it appears, is at last firmly embracing the practical utility of these policy tools. In the end, while the small business procurement policy in the United States appears to be relatively more sophisticated and further advanced, the ever-increasing size of the European common market and the convergence in transatlantic small business policies could compensate for the current limitations of the European approaches.

From the standpoint of U.S.-EU trade relations, it is clear that the European Commission's complaints about the U.S. Small Business Act disregards similar European policies and practices. The Europeans have a substantial history of set-asides and reservations in targeted procurement sectors and programs at the prime contracting level as well as subcontracting level. Further, the Europeans have justified these measures based on the needs to increase international competitiveness and to promote a stronger defense industrial base. Accordingly, policymakers in the United States must be mindful of the fact that competing foreign nations consider the Small Business Act of 1953 to be one of the most powerful industrial base and competitiveness policy tools, and seek to emulate the Act themselves. Indeed, the Europeans seek to emulate the U.S. Small Business Act in order to secure global technological supremacy, even though the SME share of European contracts appears to almost double the U.S. share at the present time. This would pose a serious long-term industrial competitiveness challenge to the U.S. defense and civilian sectors if the U.S. Government fails to maintain strong set-asides and other small business preferences, especially for high-tech small firms. In addition, European SME preferences contain multiple loopholes allowing for fraud and manipulation by large conglomerates, while enforcement measures appear to be lacking. In these circumstances, the United States would be well-justified in refusing European demands to waive or repeal the Small Business Act. Abandoning the Small Business Act or generally opening up U.S. small business procurements to European firms would be shortsighted and detrimental to the U.S. national interests.

This does not mean that the United States and Europe cannot ever negotiate a trade agreement to provide reciprocal procurement opportunities to each other's small businesses. However, such cooperation is better suited for limited procurement programs where both sides contribute financially, agree on a common definition of a small business and on related enforcement measures, and devise common assistance tools for small firms. The North Atlantic Treaty Organization procurements could be suitable for such an endeavor. Finally, a commonsense approach for proceeding forward would involve the United States maintaining and strengthening the U.S. Small Business Act while allowing the European SMEs the same exemptions from the WTO Agreement on government procurement that are presently afforded to U.S. small business contracts.