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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

October 14, 2011

The Honorable Mary Landrieu, Chairman
The Honorable Olympia Snowe, Ranking Member
U.S. Senate Committee on Small Business & Entrepreneurship
428A Russell Senate Office Building
Washington, DC 20510

Dear Chairman Landrieu and Ranking Member Snowe:

I write to urge you to consider two pending pieces of legislation within the Committee's jurisdiction: S. 236, which would allow small businesses to compete on a level playing field with Alaska Native Corporations in the Small Business Administration (SBA) 8(a) program, and S. 1590, which would require the SBA to develop a new, commonsense classification system for small business size determinations and eliminate unfair loopholes that may be harming small businesses. These two bills, which I introduced following hearings and investigations by the Subcommittee on Contracting Oversight, would not only ensure that federal taxpayer dollars are spent more judiciously, but would also make the small business contracting process more fair to millions of American small businesses. Both bills have now been referred to the Small Business Committee.

S. 236: A Bill to Eliminate the Preferences and Special Rules for Alaska Native Corporations Under the Program Under Section 8(a) of the Small Business Act

As you are aware, the Small Business Administration's 8(a) program was originally created to help socially and economically disadvantaged minority-owned small businesses compete during the early stages of development. However, Alaska Native Corporations (ANCs) have been given, through a series of exceptions and changes to the law over the past 30 years, special privileges above and beyond other 8(a)-eligible groups. These include exemptions from the normal requirements to establish social and economic disadvantage, exceptions that allow ANCs to exclude certain affiliates and partnerships from the size and income standard determinations that apply to other 8(a) participants, and special preferences that allow non-Native executives to manage ANCs that participate in the 8(a) program.

Over time, these special exemptions and loopholes have enabled many of these businesses to grow into multi-billion dollar businesses that are now among the largest federal contractors. And although the businesses may provide some benefits to the Alaska Native people, these benefits are far outweighed by the potential for waste, fraud, and abuse created by the contracting preferences.

On July 16, 2009, the Subcommittee on Contracting Oversight held a hearing on contracting preferences for ANCs. This hearing was the culmination of an investigation which examined several thousand pages of documents submitted by ANCs in response to my requests for detailed company data for the years 2000-2008. This investigation found that nearly 95% of ANC employees are not ANC shareholders and that 69% of executive compensation was paid to non-shareholders. In addition, the investigation found that over this time period 40 % of all ANC contract dollars were awarded to companies outside of Alaska, with 80% of all contract dollars awarded in 2008 alone going to work performed outside the state. The Subcommittee also analyzed how ANCs are passing through much of the work to large, non-Native companies.¹

In 2010, reports by the *Washington Post* provided new information about the abuses of these preferences. The *Post* found that of the 35,000 jobs worldwide provided by ANCs, only about 10% were filled by Alaska native people. One ANC, Sitnasuak, earned more than \$14.5 million in after-tax profits, but paid out only \$305 apiece to its 2,238 native shareholders. Meanwhile, the company paid more than \$8.2 million to the senior managers of a consulting group in Bethesda, Maryland – none of whom are Alaska Natives.²

The *Washington Post* also reported a pattern of lax oversight by the SBA which allowed the ANCs to award pass-through contracts to large corporations.³ Following these reports, several companies owned by or doing business with ANCs were suspended, including MultiMaxArray and EG Solutions, a company jointly owned by an ANC subsidiary and GTSI, another firm that was temporarily suspended by SBA. SBA's suspension and debarment official, Michael A. Chodos, said about the two companies, "I also find that there is adequate evidence that [these companies] committed fraud or a criminal offense."⁴

While the SBA has since updated a number of regulations intended to strengthen the 8(a) program, problems related to preferences for ANCs remain. Just last week, the Department of Justice announced that it had arrested four men in a contracting scheme involving Virginia-based EyakTek, a company owned by an Alaska Native Corporation. The scheme, which included two senior officials and the U.S. Army Corps of Engineers and the director of contracts for EyakTek, allegedly defrauded the government of more than \$20 million. According to the U.S. District

¹ U.S. Senate Committee on Homeland Security & Government Affairs, Subcommittee on Contracting Oversight, *New Information About Contracting Preferences for Alaska Native Corporations; Majority Staff Analysis* (July 16, 2009).

² *For Many with Stake in Alaska Native Corporations, Promise of Better Life Remains Unfulfilled*, *Washington Post* (Sept. 30, 2010).

³ *For Many with Stake in Alaska Native Corporations, Promise of Better Life Remains Unfulfilled*, *Washington Post* (Sept. 30, 2010); *In Deals Between Alaska Corporation and D.C. Area Contractor, a Disconnect*, *Washington Post* (Oct. 1, 2010).

⁴ *EG Solutions and MultimaxArray Suspended in SBA Contracts Probe*, *Washington Post* (Nov. 19, 2010).

Attorney responsible for the indictment, it is “one of the most brazen federal contracting scandals in our nation’s history.”⁵

These reports and incidents demand a prompt and thorough revision of the ANCs’ special treatment in the 8(a) program. Passage of S.236, which holds ANCs to the same standards as other 8(a) businesses, is a necessary first step. When ANCs are eventually required to play by the same rules as everyone else, we will have greater assurance that taxpayer dollars are being used to assist minority-owned small businesses and their communities. While I have no doubt that some ANCs are acting in good faith, passage of this bill will deter the rampant abuses in the program that continue to harm the government and taxpayer and will ensure a more level playing field for all small businesses.

S. 1590: Fairness for Small Businesses in Federal Contracting Act of 2011

To determine whether a business qualifies as “small” for the purposes of federal contracting, SBA relies on the North American Industrial Classification System (NAICS). This system, comprised of more than 1,200 codes for all types of industries – from ship building to food preparation – was developed by the Office of Management and Budget and never intended for use in federal contracting.⁶

On July 26, 2011, the Subcommittee on Contracting Oversight held a hearing on ways in which big businesses can get and keep small business contracts. The Subcommittee found several problems with the application of the NAICS system to contracting, including instances where businesses lobbied the contracting official to assign NAICS codes that would give the contractor a more beneficial size standard and an exception for “nonmanufacturers” where businesses who do not manufacture any product are counted as manufacturers and thus are eligible for a larger size standard, including businesses with up to 1,000 employees. In addition, representatives of small businesses told the Subcommittee that the complicated system might be a barrier to entry for some small businesses.⁷

Since 2005, the SBA Inspector General has listed as one of the agency’s top management challenges the fact that large firms are obtaining small business contracts and agencies are counting contracts performed by large businesses toward their small business goals. According to the Inspector General, many contract awards recorded as going to small businesses are

⁵ *Four Arrested in Government Bribery and Contracting Scam, The Washington Post* (Oct. 4, 2011).

⁶ U.S. Census Bureau, *Briefing for Subcommittee Staff* (July 7, 2011); U.S. Small Business Administration, *SBA Size Standards Methodology* (April 2009); 48 C.F.R. § 19.102.

⁷ U.S. Senate Committee on Homeland Security & Government Affairs, Subcommittee on Contracting Oversight, *Hearing on Small Business Contracts: Examining how Oversight Failures and Regulatory Loopholes Allow Large Businesses to Get and Keep Small Business Contracts* (July 26, 2011).

actually performed by large businesses.⁸ NAICS code classifications contribute to this problem. In one example discussed at the Subcommittee's hearing, a \$2 billion dollar maintenance and repair contract was awarded under the NAICS code for aircraft manufacturing, which has a size standard of 1,500 employees. The contractor was determined to be a small business under this NAICS code. If the contract was awarded under the NAICS code for repair and maintenance, the contractor would have exceeded the size standards and would not have been determined to be a small business.⁹

S. 1590 would require SBA and the Federal Acquisition Regulatory Council to develop a new, commonsense system within a set of reasonable guidelines to make contracting more accessible for our nation's small businesses and close existing loopholes. Without attention to this dysfunctional system, huge corporations will continue to pilfer resources from the neighborhood businesses that need them the most.

S. 1590 would also eliminate the loophole created by the SBA for "nonmanufacturers," where contracting officials are forbidden to apply the size standards for resalers and wholesalers entering into certain contracts with the federal government. The bill would require the SBA to eliminate this loophole, allowing contracting officers to use standards for resale and wholesale in applicable situations, which would increase the opportunities for small businesses in these fields to compete.

An indispensable component of our larger economic recovery must include efficient, well-targeted support for our small businesses. I ask that you consider these proposals while Congress moves to get Americans back on their feet.

Thank you for your consideration of this request, and I look forward to working with you in the future. Please contact me or ask your staff to contact Margaret Daum with the Subcommittee staff at (202) 224-4462 with any questions.

Sincerely,



Claire McCaskill
Chairman
Subcommittee on Contracting Oversight

⁸ U.S. Small Business Administration Office of the Inspector General, *Fiscal Year 2011 Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration* (Oct. 15, 2011) (Report No. 11-01).

⁹ U.S. Small Business Administration, *Table of Small Business Size Standards Matched to North American Industrial Classification System Codes* (November 5, 2010) (online at <http://www.sba.gov/content/table-small-business-size-standards>).

cc: Rob Portman
Ranking Member
Subcommittee on Contracting Oversight