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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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MAY 5 1975

The Honorable Joe L. Evins
Chairman, Committee on
Small Business
House of Representatives

Dear Mr. Chairman:

In response to your July 11, 1974, request, we have examined the circumstances surrounding the Small Business Administration's (Administration's) award of a section 8(a) contract for Visual Approach Slope Indicators to Western Technical Associates, an 8(a) approved firm. Your interest concerned

--whether Western Technical is eligible as a firm owned, operated, and controlled by a "disadvantaged individual" and

--whether Administration regulations regarding acceptable contracting opportunities were violated because of this set-aside.

We reviewed records and interviewed representatives at the Los Angeles and Washington, D.C., offices of the Administration and the Department of Transportation's Federal Aviation Administration office in Washington, D.C. We also interviewed principals of Western Technical in Los Angeles, as well as the four other small businesses manufacturing Indicators.

As you know, our work was delayed since our manpower resources were committed to fulfilling the mandate imposed upon us by Public Law 93-386, which requires a full-scale audit of the Administration and all its field offices.

BACKGROUND

Under section 8(a) of the Small Business Act of 1953, as amended, the Administration channels Government purchases to small businesses owned and controlled by socially or economically disadvantaged persons by contracting to provide supplies or services to a Federal agency and then subcontracting the contract's performance. The Administration has used 8(a) authority to develop a program to help small businesses which are owned and controlled by disadvantaged persons achieve a competitive position in the marketplace. Since 1968, when the 8(a) program was

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started, the Administration has awarded 6,912 subcontracts, totaling $737,100,000, to over 2,800 businesses.

On May 28, 1972, the Administration authorized Western Technical --a small business providing engineering design, development, and manufacturing through electronic systems--to participate in the 8(a) program. The firm has been awarded twelve 8(a) contracts, totaling an estimated $3,019,493, including the Indicator contract mentioned in your letter. Western Technical's 8(a) contract to manufacture 110 Indicators for the Federal Aviation Administration was signed on November 23, 1973, and shipment of the Indicators was completed on September 30, 1974. Western Technical was awarded three additional 8(a) contracts after receiving the subject Indicator contract. The Administration has projected 8(a) assistance for Western Technical through fiscal year 1975.

A Visual Approach Slope Indicator is a navigational light aid designed to give a pilot visual descent guidance on airport approaches. The guidance provided by the Indicator can help

--prevent overshoots and undershoots on landing,

--abate noise, and

--insure that hazards in approach paths are avoided by landing aircraft.

ELIGIBILITY

In using 8(a) authority the Administration is interested in assisting firms which had been unable to achieve self-sufficiency through competition in the marketplace. The Administration's concept is that 8(a) subcontracts give a firm enough work to operate profitably while permitting the firm to concentrate on developing its own commercial sales.

The Administration requires that 51 percent of a firm be owned and controlled by socially or economically disadvantaged persons to be eligible for the 8(a) program. Its regulations state that disadvantage "may arise from cultural, social, or chronic economic circumstances or background or other similar cause." Such persons include, but are not limited to, members of the following minority groups: black Americans, American Indians, Spanish Americans, oriental Americans, Eskimos, and Aleuts. Vietnam-era service in the Armed Forces is also a contributing factor in establishing social or economic disadvantage.

The Administration's General Counsel has published additional factors, based on his interpretation of the Economic Opportunity Act, to be considered in evaluating an applicant's status. An applicant may be considered disadvantaged because:

--His social background has prevented him from obtaining technical assistance or financing of a quality or quantity similar to that available to the average entrepreneur.

--Past discrimination based upon race, religion, or ethnic background has impeded his normal entry into the economic mainstream.

--He has been frequently or marginally unemployed due to his residency in depressed areas or due to past discrimination based upon race, religion, or ethnic background.

--He has been chronically in a low-income status.

The General Counsel emphasized that the Administration's eligibility determinations should carefully avoid any implication that eligibility is principally based on race, creed, or ethnic background.

These criteria are for the most part general and stress social causes of disadvantage. In November 1974 Administration headquarters issued revised procedures to its field offices which according to the Administration further clarifies the criteria.

The Administration has declared that Mr. John Redmond, Jr., controlling owner and president of Western Technical since 1970, and Mr. George Niles, founder and secretary-treasurer, are disadvantaged and that Western Technical is eligible to receive subcontracts under the 8(a) program.

Western Technical was formed as a proprietorship in 1968 and incorporated in 1970. Mr. Redmond, a black American, purchased 52 percent of the stock and three nonminorities, Messrs. Niles, Gary S. Alexander, and Steven Morris, purchased 16 percent each. Although a physical handicap is not specifically mentioned as 8(a) eligibility criteria, the Administration has determined Mr. Niles to be socially disadvantaged because of a physical handicap. The basis for the determination was not documented in district office files.

The Administration based its rationale in declaring Mr. Redmond disadvantaged on social rather than economic causes. As stated in district office files, Mr. Redmond

"* * * was subjected to social disadvantage from early childhood that relegated him to menial tasks and low pay brackets. But he struggled for an education and succeeded in achieving a BS Degree in mathematics. He managed to obtain work in the technical field with three firms between 1964 and 1970 when Western Technical Associates Inc. was formed."

Mr. Redmond never had controlling ownership of a company before his association with Western Technical; however, he had held middle- and upper-management positions with three other firms.

Although Mr. Redmond has held responsible management positions in the past, it is impossible to determine if Western Technical could have succeeded without 8(a) subcontracts.

Mr. Redmond meets Administration criteria for disadvantaged individuals. However, we have issued a report to the Congress[1] on the effectiveness of the 8(a) program in which we discuss in detail the Administration's eligibility criteria for the program.

ADMINISTRATIVE PROCEDURES OF THE ADMINISTRATION

Under guidelines existing at the time of contract award, the Administration did not exceed its authority in accepting the Federal Aviation Administration's contract for producing 110 Indicator systems. Administration internal regulations for the 8(a) program, issued in August 1973, state that contracting opportunities will not be sought or accepted where one or more of the following circumstances exist:

--"The amount considered for 8(a) contracting, whether individually or collectively, is excessive in relation to the total purchases of like or similar products, or services procured by the Federal Government. No quantity in excess of 20 percent may be requested without the approval of the Associate Administrator for Procurement and Management Assistance.[2]

--"Public solicitation has already been issued to the small business community under a Small Business Set-Aside for the specific procurement in question * * *. Past procurement

[1]Questionable Effectiveness of the 8(a) Procurement Program" (GGD-75-57, Apr. 16, 1975).

[2]The 20-percent ceiling was eliminated when the Administration revised its internal regulations in November 1974.

actions and future probabilities (including the appearance of products in catalogs) do not preclude prospective procurement actions from 8(a) consideration.

--"The procuring activity can make an award directly to a small business concern owned by eligible disadvantaged persons, or where there is a reasonable probability that a competitive award can be won by such a small business concern, or

--"It is determined by the SBA [Small Business Administration] that a small business concern may suffer a major hardship if the procurement is removed from competition, thereby denying the concern (otherwise historically dependent on such recurring procurements) the opportunity to compete. The basis for establishing this is that the firm is a regular producer receiving one or more awards within the past year, and is dependent upon such business as a significant part of its overall sales."

FEDERAL AVIATION ADMINISTRATION INDICATOR PROCUREMENTS

The Federal Aviation Act of 1958 (49 U.S.C. 1348, 1421) gives the Federal Aviation Administration the responsibility to acquire, establish, improve, operate, and maintain air navigation facilities. Pursuant to this responsibility the Federal Aviation Administration purchases airport equipment such as Indicator systems.

The Federal Aviation Administration, through its Airway Facilities Service, purchases almost all Visual Approach Slope Indicators procured by the Government. The Airway Facilities Service, in a 5-year plan, outlines specific procurement requirements for major airports identified for development. Annually, the Service requests the Congress to appropriate funds for each type of improvement outlined in the 5-year plan. During fiscal years 1970-73, the Congress did not appropriate any money for purchasing Indicator systems. In fiscal year 1974, however, the Congress appropriated $943,377 for procuring 110 Indicator systems. The contract for this entire procurement was accepted for the 8(a) program.

Administration policy at the date of the contract stated that an 8(a) contract, with certain exceptions, shall not exceed 20 percent of the Government's total purchase of "like or similar products." The Administration applies this criterion to annual national buys;[1] however,

[1]A "national buy" item is a supply or service purchased to meet the needs of a logistic system where supply control, inventory management, and procurement responsibility have been assigned to a central activity to support the needs of two or more users of the item.

it does not recognize the procurement of Indicators alone as the universe of a national buy. Noting legal precedents, the Administration's Assistant General Counsel has interpreted the term "like or similar" not to mean identical. He stated, in part:

> "* * * the term like or similar has a considerably broader scope than one item. * * * It is our opinion that like or similar items refer to the end point usage of the item * * * material used * * * and the manufacturing process * * * involved."

According to Administration officials, the universe of this national buy is composed of all airport ground lighting systems. Besides Indicators this market includes beacon lights, approach lighting systems, runway markers, taxiway lights, and runway-end identifier lights. The Administration determined that the Federal Aviation Administration spent $3.16 million in fiscal year 1974 for the overall national buy of airport ground lighting systems. Based on this data, Western Technical's contract, amounting to $516,000, accounted for about 16 percent of the Federal Aviation Administration's national buy for fiscal year 1974. (We could not determine the national buy for the entire Federal Government.) With the universe of the national buy viewed in this way, setting aside this procurement did not violate the policy limiting 8(a) contracts to 20 percent of the Government's total purchases of like or similar products. Even if the 20-percent limitation was exceeded it would not render the contract illegal since the Administration is not irrevocably bound by its policy and could waive the policy if it chose to do so.

In addition to direct procurement of airport lighting equipment, the Federal Aviation Administration through its Airports Service makes grants to airports to purchase equipment, including Indicators, through the Airport Development Aid Program. Only Indicators not included in the Airway Facilities Service's 5-year plan are eligible for an Airport Development grant. Each grant is based on planned improvements outlined in the application filed by an airport sponsor. Unlike Airway Facilities Service procurements, Airport Development grant recipients can buy equipment only from Federal Aviation Administration-approved manufacturers. From fiscal years 1970-73, the Congress authorized about $280 million each year for Airport Development grants. The fiscal year 1974 authorization was $310 million. That year the Airports Service approved Airport Development grants for purchasing an estimated 268 Indicators. Thus, during fiscal year 1974, the Federal Aviation Administration funded about 378 Indicator purchases, of which 110 systems, or about 29 percent, were provided through the subject 8(a) contract with Western Technical.

Impact on competing small businesses

The removal of this Federal Aviation Administration procurement from the competitive market does not appear to have caused any major hardship on manufacturers competing for Indicator contracts. Federal Aviation Administration records showed that only five companies other than Western Technical have demonstrated a capability to manufacture Indicators meeting Federal Aviation Administration specifications. Four of these firms--Multi-Electric Manufacturing, Inc.; Airport Lighting and Navigational Aids Company; Hughey & Phillips; and SEPCO Division of Connecticut International Corp.--said they were small businesses. The fifth firm--Sylvania of General Telephone and Electric --is a large business for which Indicator sales represent only a small portion of total sales. Each small firm manufactures a complete line of airport lighting systems. Although principals of these firms said that Indicators were a key product, each manufacturer attributed less than 10 percent of total current annual sales to them.

According to representatives of these firms, the primary buyers of Federal Aviation Administration-approved Indicators are Federal Aviation Administration regional offices, airport sponsors receiving Airport Development funds, and foreign airports. The Airport Development grant recipients have purchased most of the Indicators. One of the above companies, for example, sells 60 percent of its Indicator systems to airports using Airport Development funds, and another attributed 95 percent of its Indicator sales to grant recipients. Under Federal Aviation Administration guidelines, Indicators identified for installation under the Airway Facilities Service's 5-year plan are not eligible for Airport Development funds. Furthermore, Indicator procurements by the Airway Facilities Service were nonexistent between fiscal years 1969-73 and, therefore, could not have been a procurement upon which these small businesses relied. Thus, setting aside the Service's contract for 110 Indicators did not diminish the normal competitive Indicator market.

The owners of the four competing small businesses manufacturing Indicators could not attribute a loss in sales or a reduction in their number of employees to the subject contract. Representatives of three of these firms stated that they had not planned annual production in anticipation of this procurement. Thus, the setting aside of this contract did not have a negative effect on the four small businesses; rather, they lost a sales opportunity that was unexpectedly added to the Indicator market.

Officials of the Small Business Administration, the Federal Aviation Administration, and Western Technical Associates agreed with the facts contained in this report.

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We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States