



DOCUMENT FOR PUBLIC RELEASE

The decision issued on the date below was subject to a GAO Protective Order. This redacted version has been approved for public release.

Decision

Matter of: Knudsen Systems, Inc.

File: B-422433.2

Date: August 9, 2024

Thomas M. Craig, Esq., and Emily A. Spence, Esq., Fluet & Associates, PLLC, for the protester.

Christopher Lybeck, Esq., and Laura A. Whitten, Esq., Department of the Navy, for the agency.

Kyle E. Gilbertson, Esq., and Peter H. Tran, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

Protest is sustained where agency's market research was insufficient to conclude that agency would likely receive proposals from at least two responsible small business concerns that could meet solicitation's requirements at a fair market price, and therefore, agency's decision to restrict solicitation to small businesses was unreasonable.

DECISION

Knudsen Systems Inc. (KSI), a woman-owned small business of Ogdensburg, New York, protests the terms of amendment 4 to request for proposals (RFP) No. N0025323R0022, issued by the Department of the Navy, Naval Undersea Warfare Center (Navy), for sound navigation and ranging (SONAR) sounding sets. The protester argues that the solicitation's amended terms render the agency's market research and resulting set-aside decision unreasonable, and therefore contends that the requirement should be competed on an unrestricted basis.

We sustain the protest.

BACKGROUND

On June 1, 2023, the Navy issued the RFP as a total small business set-aside pursuant to the procedures of Federal Acquisition Regulation (FAR) part 15 and subpart 19.5.

Contracting Officer's Statement (COS) at 3; Agency Report (AR), Tab I, RFP at 1, 37.¹ The solicitation seeks proposals for the production, testing, and delivery of SONAR sounding sets for use on Navy ships.² RFP at 2-4, 101. The RFP contemplates the award of a single indefinite-delivery, indefinite-quantity fixed-price contract. *Id.* at 2-6, 88, 101. The solicitation provides for a best-value tradeoff source selection process, using the following three evaluation factors, listed in descending order of importance: (1) technical; (2) past performance; and (3) price. *Id.* at 101-102.

The agency assigned North American Industry Classification System (NAICS) code 334511 to the solicitation, which applies to search, detection, navigation, guidance, aeronautical, and nautical system and instrument manufacturing.³ *Id.* at 68, 89. When it was initially issued in June 2023, the solicitation did not include FAR clause 52.219-33 (Nonmanufacturer Rule). Instead, the RFP informed offerors that the Small Business Administration (SBA) had issued a nonmanufacturer rule "class waiver for NAICS Code 334511." *Id.* at 89. Two offerors, KSI and SyQwest, Inc., submitted proposals by the July 14 due date. COS at 5. In its proposal, KSI explained that it intended to use SONAR equipment manufactured in Canada by [DELETED]. Comments at 1.

On November 15, after the Navy had completed its evaluation, the agency discovered that the SBA class waiver referenced in the RFP did not, in fact, apply to the SONAR sounding sets being procured, and therefore the RFP's notification regarding the class waiver was in error. COS at 5. As a result, the agency determined that KSI was ineligible for award because it was "unable to comply with the non-manufacturer rule." Memorandum of Law (MOL) at 4. The Navy also contacted the SBA procurement center representative, who confirmed KSI's ineligibility due to the firm's proposed use of a Canadian product to satisfy the solicitation's requirements. COS at 5.

On March 1, 2024, the Navy notified KSI that it intended to award the contract to SyQwest as the best-value proposal, in the amount of \$2,528,875. Protest at 3; COS at 5. As part of the debriefing, the contracting officer informed KSI that its proposal was found to be unacceptable because the firm intended to use products manufactured in Canada. KSI Extended Debriefing Letter at 1. KSI protested the award to our Office on March 15. *Knudsen Sys., Inc.*, B-422433, Apr. 18, 2024 (unpublished decision). KSI's initial protest alleged, among other things, that the Navy's "assessment that KSI was not

¹ Citations are to the Adobe PDF page numbers for each of the individual documents in the agency report. The agency amended the RFP four times. The initial RFP is provided at tab I of the agency report, and amendment 4 to solicitation is found at tab P.

² A SONAR sounding set measures the depth of water beneath the lowest projection on a vessel. AR, Tab B, Statement of Work at 4.

³ NAICS is the standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the business economy of the United States. NAICS areas are designated by a unique number, or code. *The Elec. On-Ramp, Inc.*, B-421229.4, Feb. 22, 2023, 2023 CPD ¶ 58 at 5 n.6.

eligible for award because the Solicitation did not contain FAR 52.219-33 is inconsistent with the terms of the Solicitation and FAR 19.507(h)(2).” Protest (B-422433.1) at 17.

On April 12, in response to KSI’s protest, the agency advised our Office that it would take corrective action by “amending the solicitation to implement the correct nonmanufacturer rule status, conducting discussions to enable offers to revise their proposals, re-evaluating proposals as appropriate, and making a new award decision.” AR, Tab M, Notice of Corrective Action at 1. We dismissed KSI’s protest as academic. *Knudsen Sys., Inc., supra*.

To implement its corrective action, the agency issued amendment 4. AR, Tab P, RFP amend. 4 at 1. The Navy distributed this solicitation amendment--as part of the agency’s discussions with offerors--only to KSI and SyQwest, the two offerors that had submitted proposals. AR, Tab Q, RFP amend. 4 Correspondence at 1-6. Relevant here, amendment 4 removed the RFP’s reference to any SBA class waiver for NAICS code 334511, and instead inserted FAR clause 52.219-33 (Nonmanufacturer Rule). AR, Tab P, RFP amend. 4 at 1-3. The solicitation remained a total small business set-aside. *Id.* at 2.

As part of discussions, KSI and SyQwest were provided with the opportunity to submit final proposal revisions by May 17 or, alternatively, to affirm the validity of their initial proposals. Protest, exh. B, Discussion Letter at 1-2; AR, Tab P, RFP amend. 4 at 1. Both KSI and SyQwest affirmed that their initial July 2023 proposals would serve as their final proposals. AR, Tab Q, RFP amend. 4 Correspondence at 3, 6. On May 16, however, before the deadline to submit final proposals, KSI filed this protest challenging the terms of amendment 4.

DISCUSSION

KSI challenges the agency’s decision to continue to set aside the procurement for small businesses, considering the amended terms of the solicitation. Protest at 4. In the protester’s view, the Navy should have performed new (or updated) market research prior to issuing amendment 4. *Id.* If that research failed to support the agency’s set-aside decision, KSI argues, the solicitation should have been reissued as a full and open competition. *Id.* at 5. The Navy responds that it has a reasonable basis to set aside this procurement for small businesses. MOL at 3. We have considered the arguments and issues raised by KSI, and while we do not address them all, we sustain KSI’s challenge to the agency’s market research and resulting set-aside determination.

Set-Aside Determination

The protester challenges the Navy’s set-aside decision in light of amendment 4’s removal of the class waiver and insertion of the nonmanufacturer rule requirement. Protest at 4-5. Specifically, KSI contests the adequacy of the agency’s market research, arguing that the Navy failed to conduct sufficient additional research to

support the agency's determination that it would receive proposals from two or more responsible small businesses. *Id.*

Under section 19.502-2(b) of the FAR, commonly referred to as the "rule of two" requirement, agencies are required to set aside for small business participation, a procurement valued over the simplified acquisition threshold, when there is a reasonable expectation that offers will be obtained from at least two responsible small business concerns, and that award will be made at a fair market price. FAR 19.502-2(b).

Generally, we regard such set-aside decisions as a matter of business judgment within the contracting officer's discretion that we will not disturb absent a clear showing that it was unreasonable. *AeroSage, LLC*, B-416381, Aug. 23, 2018, 2018 CPD ¶ 288 at 8. The decision whether to set aside a procurement may be based on an analysis of factors such as the prior procurement history, the recommendations of appropriate small business specialists, and market surveys that include responses to sources sought announcements. *Commonwealth Home Health Care, Inc.*, B-400163, July 24, 2008, 2008 CPD ¶ 140 at 3. The use of any particular method of assessing the availability of small businesses is not required. *Mountain W. Helicopters, LLC; Trans Aero, Ltd.*, B-408150, B-408150.2, July 1, 2013, 2013 CPD ¶ 152 at 2-3. The assessment must nevertheless be based on sufficient facts so as to establish its reasonableness. *Safety Storage, Inc.*, B-280851, Oct. 29, 1998, 98-2 CPD ¶ 102 at 3.

Market Research

Prior to issuing the solicitation, the agency published two sources sought notices on SAM.gov. COS at 3. The responses to the second notice, posted on November 8, 2022, formed the basis for the agency's set-aside decision.⁴ AR, Tab D, Second Sources Sought Notice at 1; AR, Tab G, Market Research Report at 3. The sources sought notice requested information from prospective offerors regarding "industry capabilities of large and small business entities." AR, Tab D, Second Sources Sought Notice at 1. The sources sought questionnaire requested a responding firm to identify its socioeconomic small business size status, as well as asked technical questions regarding the firm's familiarity, experience, and capabilities with SONAR sounding sets. AR, Tab E, Second Sources Sought Questionnaire at 1-6. For example, the agency asked firms to describe their "historical experience completing work on similar systems

⁴ Although the agency posted a first sources sought on June 29, 2021, it later issued a second sources sought on November 8, 2022, because the Navy felt the earlier information was "dated, lack[ed] the necessary questions and the market [had] experience[ed] significant pandemic related economic upheaval." AR, Tab A, First Sources Sought Notice at 1; AR, Tab G, Market Research Report at 3. The agency represents that it did not use the responses from the first sources sought when making its set-aside determination. MOL at 3 n.1. Therefore, any discussion of the sources sought notice refers to the notice issued on November 8, 2022.

at a similar complexity,” or, alternatively, to describe how the firm “would be capable of meeting these requirements as of contract award.” *Id.* at 5.

The Navy received responses from five prospective offerors; all were small businesses. Tab G, Market Research Report at 2. All five firms indicated, to varying degrees, that they planned to propose under any subsequent solicitation of this requirement. *Id.* at 3. The agency’s market researcher, a Navy engineer, reviewed and analyzed the responses to determine whether the firms possessed the technical capability to perform the requirements. *Id.* at 7-9; COS at 2. The Navy engineer concluded that three of the responding small businesses could perform, possessing a “high capability of meeting the technical requirement”: KSI, SyQwest, and Offeror C. AR, Tab G, Market Research Report at 4-5. The market research report, therefore, recommended soliciting the requirement as a total small business set-aside, finding that “[a]t the time of this report, two or more small businesses have been identified as being fully capable of meeting the requirement as prime contractors.” *Id.* at 10.

On April 6, 2023, the SBA procurement center representative concurred with the recommendation to set aside the procurement for small businesses because the “[m]arket research shows a reasonable expectation that the Government will receive two or more offers from small businesses.” AR, Tab H, Small Business Coordination Record at 1. The Navy issued the RFP as a total small business set-aside on June 1. RFP at 1, 37. As initially drafted, the RFP informed offerors that the SBA “has issued a class waiver” to the nonmanufacturer rule for NAICS code 334511. *Id.* at 89.

In November 2023, months after the decision had been made to set aside the solicitation for small businesses, the Navy discovered that there was, in fact, no class waiver applicable to the SONAR sounding sets being procured. COS at 2. Instead, the contracting officer had “incorrectly assumed the waiver applied to the entire NAICS code” and failed to recognize that “the waiver only applied to one specific piece of aviation electronics equipment and did not apply to any SONAR devices.” *Id.* Because of this error, the solicitation had not included FAR clause 52.219-33 (Nonmanufacturer Rule), and instead erroneously stated that an SBA class waiver applied to NAICS code 334511.⁵ *Id.*; MOL at 4. In the agency’s own words, the RFP had “inaccurately

⁵ When a solicitation is set aside for small business, to qualify as an eligible small business concern to provide manufactured products or other supply items for a procurement assigned a manufacturing or supply NAICS code, an offeror must be the manufacturer or producer of the end item being procured. 13 C.F.R. § 121.406(a)(1). If the offeror does not manufacture the item being purchased, the “nonmanufacturer rule” provides that the offer of a nonmanufacturer small business concern can be considered, provided the small business offeror, among other things, represents that it will supply the product of a domestic small business manufacturer or processor, or that a waiver of this requirement is granted by the SBA. 13 C.F.R. § 121.406(b). Whether the nonmanufacturer rule should be included in a procurement set aside for small businesses primarily depends on the NAICS code assigned to the procurement by the

(continued...)

informed offerors the nonmanufacturer rule was waived when the waiver only applied to one specific piece of aviation electronics equipment not related to this requirement.” AR, Tab O, BCM at 12. In response to KSI’s first protest (B-422433), the Navy issued amendment 4 to remove any reference to the SBA class waiver and to insert FAR clause 52.219-33 (Nonmanufacturer Rule) into the solicitation. AR, Tab P, RFP amend. 4 at 1-3.

Effect of Amendment 4

The protester contends, as a result of the changes implemented by amendment 4, specifically, the inclusion of the nonmanufacturing rule, that the Navy’s market research provides insufficient support for the agency’s decision to set aside this requirement for small businesses. Protest at 4. In the protester’s view, had the Navy conducted “market research when it took corrective action and issued Amendment 4, it would have recognized that the Rule of Two could not be satisfied and would have issued the work under the Solicitation as full and open competition.” Comments at 10. In essence, the protester contends the agency’s market research does not establish that there are two or more small businesses that can meet the terms of the amended solicitation which now include the requirements of the nonmanufacturing rule.

A contracting agency’s investigation to determine the availability of responsible small business concerns for set-aside purposes must address not only the existence of small businesses that might submit proposals, but also their capability to perform the contract; the fact that multiple small businesses are identified in the course of market research is not necessarily determinative. *Triad Isotopes, Inc.*, B-411360, July 16, 2015, 2015 CPD ¶ 220 at 5. Where the nonmanufacturer rule applies to a set-aside, and the agency’s market research fails to consider whether the firms identified in the market research can comply with the rule, the market research is unreasonable. *Walker Dev. & Trading Grp., Inc.*, B-414365, May 18, 2017, 2017 CPD ¶ 151 at 3-4.

Our review finds--and the record confirms--that the Navy failed to assess whether there were two or more small businesses that could comply with the nonmanufacturer rule. Specifically, the agency’s market research and set-aside decision were based on the Navy’s mistaken assumption that the SBA had issued a class waiver for all of NAICS code 334511. By its own admission, the Navy was operating under this assumption until November 2023. COS at 2. As a result, all of the subsequent actions taken--and documents produced--by the agency relied on the erroneous assumption that the nonmanufacturer rule did not apply to the procurement.⁶ *Id.*

procuring agency. *BlueStar Energy Sols.*, B-405690, Dec. 12, 2011, 2011 CPD ¶ 275 at 3.

⁶ These actions and documents include: (1) the November 8, 2022, sources sought notice; (2) the April 4, 2023, market research report; (3) the April 17, 2023, small business coordination record; and (4) the agency’s June 1, 2023, issuance of the RFP as a small business set-aside.

This flawed assumption pervades the agency's market research, particularly regarding the agency's assessment of KSI's technical capability. For example, the market research report concluded that KSI--a firm the Navy now considers ineligible for award under the nonmanufacturer rule--could perform the work. AR, Tab G, Market Research Report at 4. The Navy's market research reached this conclusion even though KSI's response to the sources sought notice explicitly indicated the firm would supply equipment manufactured by the Canadian company, [DELETED]. Specifically, KSI's response stated that it was the "[DELETED] domestic representative for the manufacturer [DELETED]." AR, Tab F, Sources Sought Responses at 4. KSI explained that it serves in an [DELETED] for [DELETED], including providing "domestic point of sale, [DELETED] including U.S. Customs entry and clearance of goods from Canada to the U.S., as well as return of goods from the U.S. to the Canadian factory." *Id.* at 4-5.

Under the assumption that a class waiver applied, the Navy's market research did not assess KSI's ability to comply with the nonmanufacturer rule before concluding that KSI displayed "a high capability of meeting the technical requirement and poses low risk of timely successful completion." AR, Tab G, Market Research Report at 4. Moreover, to further support the Navy's set-aside decision, the market research report explicitly relied on KSI's previous work providing [DELETED] manufactured products to the Navy. AR, Tab G, Market Research Report at 4; AR, Tab H, Small Business Coordination Record at 2. That is, in referencing the Navy's previous awarded contract to KSI "for the subject items"--a procurement that was not subject to the nonmanufacturer rule--the market research report concluded that KSI "is capable of developing, and has already developed, an item that would be capable of meeting the Navy's requirement, and is what the Navy is using currently." AR, Tab H, Small Business Coordination Record at 2.

Additionally, even though two other small businesses (SyQwest and Offeror C) were found to possess a "high capability" to perform the work, the market research similarly did not assess whether those firms could comply with the nonmanufacturer rule.⁷ AR, Tab G, Market Research Report at 4-5. The record, therefore, demonstrates that the Navy's market research failed to consider whether prospective small business offerors could comply with the nonmanufacturer rule before concluding that "[a]t the time of this report, two or more small businesses have been identified as being fully capable of meeting the requirement as prime contractors." *Id.* at 10.

Thus, it is plainly evident the Navy's initial decision to set aside the procurement for small businesses was premised on an erroneous assumption that resulted in flawed market research. Indeed, the Navy, itself, acknowledges that the agency's market

⁷ Although it submitted a response to the sources sought notice, Offeror C did not submit a proposal responding to the RFP. AR, Tab G, Market Research Report.

research was performed under the assumption that there was an SBA class waiver to the nonmanufacturer rule for all of NAICS code 334511.⁸

The Navy argues it should be allowed to use the earlier (flawed) market research, nonetheless, as the basis for its (continued) decision to set aside the procurement for small businesses and that the agency was under no obligation to revisit its market research in light of the addition of the nonmanufacturing rule through amendment 4. We disagree. Where, as here, the agency's market research was flawed and based on inaccurate information, it cannot adequately form the basis to support a reasonable set-aside decision by the agency. *Triad Isotopes, Inc.*, B-411360, July 16, 2015, 2015 CPD ¶ 220 (finding market analysis was flawed in part because agency failed to consider whether offerors were eligible due to the nonmanufacturer rule).⁹

⁸ Specifically:

As PCO [procuring contracting officer], I incorrectly assumed the waiver applied to the entire NAICS code and failed to identify the waiver only applied to one specific piece of aviation electronics equipment and did not apply to any SONAR devices. As a result of this mistake, I did not include FAR 52.219-33 Nonmanufacturer Rule in the RFP and incorrectly indicated in Section L that the waiver applied to the entire NAICS.

COS at 2.

⁹ The agency argues our decision in *Triad Isotopes* is "markedly dissimilar" because, there, the agency's market research simply relied on "databases with the applicable NAICS code or the incumbent's status as a small business," whereas here the Navy's "rule of two" analysis "consisted of two rounds of detailed sources sought and coordination with the small business representative." MOL at 6. We decline to read that decision so narrowly.

In *Triad Isotopes*, the protester contended that, without considering whether any of the identified businesses, or the incumbent contractor, could provide the solicited radioisotopes "or otherwise meet the nonmanufacturer rule, the contracting officer could not have known, based on the market research, whether any of the identified businesses qualify as small for this procurement." *Triad Isotopes, supra* at 6. There, the contracting officer "conceded that she did not assess whether the incumbent contractor met the eligibility requirements under the RFQ's NAICS code to qualify as a small business concern for this procurement," including whether the incumbent "may not be able to meet the nonmanufacturer rule." *Id.* at 9. Based on the record, we found the contracting officer's "reliance on the assumption that the incumbent contractor qualified as small in determining that there was a reasonable expectation of receiving offers from at least two responsible small business concerns was not based on sufficient facts to establish its reasonableness." *Id.* at 9-10. Here, as in *Triad Isotopes*, the agency's flawed market research is insufficient to reasonably conclude that the agency would likely receive proposals from at least two responsible small business concerns that could meet the amended requirements.

The Navy does not dispute that it did not conduct new or additional market research before issuing amendment 4. Rather, the agency relies on the prior market research that, admittedly, was based on the errant belief that a class waiver to the nonmanufacturer rule applied to the procurement. As such, the agency has, at no point during this procurement, ever conducted any market research to identify whether two or more small businesses can comply with the nonmanufacturer rule under this NAICS code. Instead, the Navy argues that it “reasonably conducted market research prior to issuing the instant solicitation,” and “had no obligation to revisit that determination.”¹⁰ MOL at 3, 6 (arguing the agency “relied on its market research, conducted prior to the solicitation’s release, and properly set aside this procurement.”). In responding to the protest, the contracting officer maintains that he “determined that the market research was sufficiently current and that there was no need or requirement to revisit or alter the set-aside determination.” COS at 5. Notwithstanding the contracting officer’s conclusions, we find unreasonable the agency’s reliance on admittedly flawed market research to support the agency’s set-aside determination. *Triad Isotopes, Inc. supra*.

Nor do we find the flawed market research is somehow absolved by the contracting officer’s conclusory statement that he “reread the market research report and sources sought responses” and “confirmed that the set-aside was a correct decision.” COS at 5. First, there is nothing in the contemporaneous record that supports this *post hoc* statement, but more importantly, the contracting officer does not proffer that he has ever assessed the capability of prospective small business offerors to comply with the

¹⁰ The agency argues our decision in *Synchrogenix Info. Strategies*, B-414068.4, Sept. 8, 2017, 2017 CPD ¶ 283, demonstrates “it is not necessary for an agency to redo its market research regarding the ‘rule of two’” should the agency later become aware that “only one responsible small business offer will be received in response to an amended solicitation.” MOL at 7. The protester in *Synchrogenix* did not, however, challenge the agency’s set-aside determination, as KSI does here.

In *Synchrogenix*, we explicitly clarified that the protester was “not challenging the agency’s initial decision to issue the solicitation as a set-aside for small businesses,” but rather was contending that the agency cannot continue the procurement as a small business set-aside “where ‘full new proposals’ are requested and where the agency knows that its request for new proposals will not result in offers from two small businesses.” *Synchrogenix, supra* at 4. *Synchrogenix* stands for the unremarkable proposition that, “[o]nce the solicitation has been issued, and the agency has properly complied with the FAR’s ‘rule of two,’ the agency is not required to revisit this determination during the course of a procurement.” *Id.* Since the agency in *Synchrogenix* had properly complied with the “rule of two,” we found “no reason to conclude that, just because the agency is aware that only one offeror will be submitted in response to the solicitation, the agency is required to cancel the set-aside.” *Id.* at 5. The distinction here is that the Navy, as discussed above, did not properly comply with the “rule of two” analysis in making the initial set-aside decision because its market research failed to consider whether prospective small business offerors could comply with the nonmanufacturing rule.

nonmanufacturer rule, or otherwise explain why there was “no need” to revisit market research that failed to make that underlying assessment. *Id.* At bottom, the agency argues that its set-aside decision represents a “reasonable business judgment,” while openly conceding it was premised on market research that had been conducted under an erroneous assumption. MOL at 6.

On this record, we find no support for the contracting officer’s assumption that any of the companies identified in the market research report were capable of performing the amended solicitation requirements. While we express no view on whether the agency might be able to support a reasonable decision to set aside this requirement for small businesses, we find that the current record provides no reasonable basis for the agency to do so here. By failing to consider whether any of the identified small businesses could satisfy the nonmanufacturer rule, the contracting officer could not have known, based on the flawed market research, whether any of the identified small businesses were actually capable of meeting the requirement at fair market prices. *Information Ventures, Inc.*, B-279924, Aug. 7, 1998, 98-2 CPD ¶ 37 at 3 (finding that the required inquiry for the contracting officer goes not only to the existence of small businesses that might submit proposals, but also to small businesses’ capabilities to perform the contract requirements).

In this regard, we have found set-aside decisions to be unreasonable where those determinations were based upon outdated or incomplete information. *DNO Inc.*, B-406256, B-406256.2, Mar. 22, 2012, 2012 CPD ¶ 136 at 4. Accordingly, we sustain the protest on this basis.¹¹ *AeroSage, LLC*, B-416381, Aug. 23, 2018, 2018 CPD ¶ 288 at 9 (sustaining protest allegation where the contracting officer’s determination that the nonmanufacturer rule did not apply and subsequent set-aside decision “was based on incomplete information”).

¹¹ In addition, the protester contends that amendment 4 “has the practical effect of excluding all offerors but SyQwest from being eligible for award,” effectively converting the solicitation into a “sole source award to SyQwest without following the process required by law when sole sourcing a procurement.” Protest at 6. For example, KSI maintains the agency’s actions in issuing amendment 4 circumvent the requirement for a justification and approval memorandum with “sufficient facts and rationale to support the specific decision not to use competition.” *Id.* As a result, the “Navy’s actions effectively amount to a sole source procurement without proper justification and approval.” Comments at 6. The agency responds that its actions did not constitute a “de-facto sole source procurement.” MOL at 3. Since we sustain the protest and our recommendation below is for the agency to revisit its market research and set-aside determination, we need not address this argument. *Triad Isotopes, Inc., supra.* at 4 n.5. The agency may want to consider this allegation in implementing our recommendation below.

Competitive Prejudice

Finally, our Office will not sustain a protest unless the protester demonstrates a reasonable possibility that it was prejudiced by the agency's actions, that is, unless the protester demonstrates that, but for the agency's actions, it would have had a substantial chance of receiving the award. *Armorworks Enters., LLC*, B-400394.3, Mar. 31, 2009, 2009 CPD ¶ 79 at 3; *Cogent Sys., Inc.*, B-295990.4, B-295990.5, Oct. 6, 2005, 2005 CPD ¶ 179 at 10. In the context of a protest challenging the terms of a solicitation, competitive prejudice occurs where the challenged terms place the protester at a competitive disadvantage or otherwise affect the protester's ability to compete. *Pond Sec. Group Italia JV-Costs*, B-400149.2, Mar. 19, 2009, 2009 CPD ¶ 61 at 4; *Crane & Co., Inc.*, B-297398, Jan. 18, 2006, 2006 CPD ¶ 22 at 9.

Here, the agency has acknowledged that KSI would be ineligible for award once the solicitation was amended to include the nonmanufacturer rule requirement. COS at 5 (stating "it was determined that KSI was ineligible for award due to the nonmanufacturer rule."). Because we find the Navy erred by failing to perform a proper "rule of two" analysis--to determine whether there was a reasonable expectation that offers will be obtained from at least two responsible small business concerns that could perform the work of the amended terms of solicitation--KSI was competitively prejudiced by the agency's unsupported decision to set aside the procurement, which substantively affected the protester's ability to compete. *Pond Sec. Group Italia JV-Costs, supra*.

CONCLUSION AND RECOMMENDATION

We find that the Navy's market research was insufficient to conclude that the agency would receive offers from at least two responsible small business concerns that could meet the requirements of the solicitation at a fair market price. For this reason, the agency's decision to restrict the solicitation to small businesses was unreasonable. We recommend that the Navy conduct proper market research, in accordance with the agency's requirements for this procurement and this decision, to ascertain whether there is a reasonable expectation that at least two or more responsible small business concerns will submit proposals at fair market prices.

We also recommend that the agency reimburse the protester the costs associated with filing and pursuing its protest, including reasonable attorneys' fees. The protester should submit its certified claim for costs, detailing the time expended and costs

incurred, directly to the contracting agency within 60 days after receipt of this decision.
4 C.F.R. § 21.8(f)(1).

The protest is sustained.

Edda Emmanuelli Perez
General Counsel