

**SMALL BUSINESS ADMINISTRATION****13 CFR Part 121**

RIN 3245-AG51

**Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade****AGENCY:** U.S. Small Business Administration.**ACTION:** Final rule.

**SUMMARY:** The U.S. Small Business Administration (SBA) modifies 36 employee based small business size standards for industries and sub-industries (*i.e.*, “exceptions” in SBA’s table of size standards) that are not part of North American Industry Classification System (NAICS) Sector 31–33 (Manufacturing), Sector 42 (Wholesale Trade), or Sector 44–45 (Retail Trade). Specifically, SBA increases 30 size standards for industries and three for sub-industries or “exceptions.” SBA also decreases size standards from 500 employees to 250 employees for three industries, namely NAICS 212113 (Anthracite Mining), NAICS 212222 (Silver Ore Mining), and NAICS 212291 (Uranium-Radium-Vanadium Ore Mining). SBA maintains the Information Technology Value Added Resellers (ITVAR) sub-industry or “exception” under NAICS 541519 (Other Computer Related Services) with the 150-employee size standard, but amends Footnote 18 to SBA’s table of size standards by adding the requirement that the supply (*i.e.*, computer hardware and software) component of small business set-aside ITVAR contracts must comply with the nonmanufacturing performance requirements or nonmanufacturer rule (NMR). Additionally, SBA eliminates the Offshore Marine Air Transportation Services sub-industry or “exception” under NAICS 481211 and 481212 and Offshore Marine Services sub-industry or “exception” under NAICS Subsector 483 and their \$30.5 million receipts based size standard. This change includes removing Footnote 15 from the table of size standards. As part of its ongoing comprehensive size standards review, SBA evaluated employee based size standards for 57 industries and five sub-industries that are not in NAICS Sectors 31–33, 42, or 44–45 to determine whether they should be retained or revised.

**DATES:** This rule is effective on February 26, 2016.**FOR FURTHER INFORMATION CONTACT:** Jorge Laboy-Bruno, Ph.D., Economist,Size Standards Division, (202) 205–6618 or [sizestandards@sba.gov](mailto:sizestandards@sba.gov).**SUPPLEMENTARY INFORMATION:****Introduction**

To determine eligibility for Federal small business assistance, SBA establishes small business size definitions (referred to as “size standards”) for private sector industries in the United States. SBA uses two primary measures of business size—average annual receipts and average number of employees. SBA uses financial assets and refining capacity to measure the size of a few specialized industries. In addition, SBA’s Small Business Investment Company (SBIC), Certified Development Company (CDC/504), and 7(a) Loan Programs use either the industry based size standards or net worth and net income based alternative size standards to determine eligibility for those programs. At the start of the SBA’s current comprehensive size standards review when the size standards were based on NAICS 2007, there were 41 different size standards covering 1,141 NAICS industries and 18 sub-industry activities (“exceptions” in SBA’s table of size standards). Thirty-one of these size levels were based on average annual receipts, seven were based on average number of employees, and three were based on other measures. Presently, under NAICS 2012, there are 28 different size standards, covering 1,031 industries and 16 “exceptions.” Of the 1,047 corresponding size standards including exceptions, 533 are based on average annual receipts, 509 on number of employees (one of which also includes barrels per day total capacity), and five on average assets.

Over the years, SBA has received comments that its size standards have not kept up with changes in the economy, in particular the changes in the Federal contracting marketplace and industry structure. The last time SBA conducted a comprehensive size standards review was during the late 1970s and early 1980s. Since then, most reviews of size standards were limited to a few specific industries, mostly with receipts based size standards, in response to requests from the public and from Federal agencies. SBA reviews all monetary based size standards (except for statutorily set size standards in NAICS Sector 11) for inflation at least once every five years. SBA’s latest inflation adjustment to the monetary based size standards was published in the **Federal Register** on June 12, 2014 (79 FR 33647). However, the vast majority of employee based size

standards have not been reviewed since they were first established.

Because of changes in the Federal marketplace and industry structure since the last comprehensive size standards review, SBA recognizes that current data may no longer support some of its existing size standards. Accordingly, in 2007, SBA began a comprehensive review of all size standards to determine if they are consistent with current data, and to adjust them when necessary. In addition, on September 27, 2010, the President of the United States signed the Small Business Jobs Act of 2010 (Jobs Act), 111 Public Law 240, 124 Stat. 2504, Sep. 27, 2010. The Jobs Act directs SBA to conduct a detailed review of all size standards and to make appropriate adjustments to reflect market conditions. Specifically, the Jobs Act requires SBA to conduct a detailed review of at least one-third of all size standards during every 18-month period from the date of its enactment. *Id.* at § 1344(a)(1)(A). In addition, the Jobs Act requires that SBA review all size standards not less frequently than once every five years thereafter. *Id.* at § 1344(a)(2). Reviewing existing small business size standards and making appropriate adjustments based on the latest available data are also consistent with Executive Order 13563 on improving regulation and regulatory review.

Rather than review all size standards at one time, SBA is reviewing size standards on a Sector-by-Sector basis. A NAICS Sector generally includes 25 to 75 industries, except for NAICS Sector 31–33, Manufacturing, which has considerably more industries. This final rule covers industries with employee based size standards that are not part of NAICS Sector 31–33 (Manufacturing), Sector 42 (Wholesale Trade), or Sector 44–45 (Retail Trade). These include one industry each in NAICS Sector 11 (Agriculture, Forestry, Fishing and Hunting), Sector 22 (Utilities), and Sector 52 (Finance and Insurance), 25 industries in Sector 21 (Mining, Quarrying, and Oil and Gas Extraction), 15 industries in Sector 48–49 (Transportation and Warehousing), 12 industries in Sector 51 (Information), two industries and four sub-industries (“exceptions”) in Sector 54 (Professional, Scientific and Technical Services), and one sub-industry (“exception”) in Sector 56 (Administrative and Support, Waste Management and Remediation Services) that currently have employee based size standards. Once SBA completes its review of size standards for industries in a NAICS Sector, it issues a proposed

rule to revise size standards for those industries based on latest industry and program data available and other relevant factors, such as current economic climate and SBA's and other government's programs and policies to help small businesses.

As part of the ongoing comprehensive size standards review, SBA also developed a "Size Standards Methodology" White Paper for developing, reviewing, and modifying size standards, when necessary. SBA published the document on its Web site at [www.sba.gov/size](http://www.sba.gov/size) for public review and comments, and included it as a supporting document in the electronic docket of the proposed rule at [www.regulations.gov](http://www.regulations.gov).

In evaluating an industry's size standard, SBA generally examines its characteristics (such as average firm size, startup costs and entry barriers, industry competition, and distribution of firms by size) and the small business level and share of Federal contract dollars in that industry. SBA also examines the potential impact a size standard revision might have on its financial assistance programs, and whether a business concern under a revised size standard would be dominant in its industry. SBA analyzed the characteristics of each industry in this final rule, mostly using a special tabulation obtained from the U.S. Bureau of the Census from its 2007 Economic Census (the latest available). The industry data in the Economic Census tabulation are limited to the 6-digit codes and do not permit the evaluation of size standards for sub-industry categories or "exceptions." Thus, as explained in the proposed rule, when establishing, reviewing, or modifying size standards for "exceptions," SBA evaluates the data from the U.S. General Service Administration's (GSA) Federal Procurement Data System—Next Generation (FPDS—NG) and System of Awards Management (SAM) databases. In this final rule, SBA used the data from FPDS—NG and SAM to determine industry and Federal contracting factors for "Information Technology Value Added Resellers," which is an exception under NAICS 541519, Other Computer Related Services, and for "Environmental Remediation Services," which is an exception under NAICS 562910, Remediation Services.

SBA also evaluated the small business level and share of Federal contracts in each industry using the data from FPDS—NG for fiscal years 2009–2011 for the proposed rule and fiscal years 2012–2014 for this final rule. To evaluate the impact of changes to size standards on

its loan programs, SBA analyzed internal data on its guaranteed loan programs for fiscal years 2010–2012 for the proposed rule and fiscal years 2012–2014 for this final rule.

SBA's "Size Standards Methodology" White Paper provides a detailed description of its analyses of various industry and program factors and data sources, and how the Agency uses the results to establish and revise size standards. In the proposed rule itself, SBA detailed how it applied its "Size Standards Methodology" to review and modify where necessary, the existing employee based size standards for industries that are not part of NAICS Sectors 31–33, 42, or 44–45. SBA sought comments from the public on a number of issues about its "Size Standards Methodology," such as whether there are alternative methodologies that SBA should consider; whether there are alternative or additional factors or data sources that SBA should evaluate; whether SBA's approach to establishing small business size standards makes sense in the current economic environment; whether SBA's application of anchor size standards is appropriate in the current economy; whether there are gaps in SBA's methodology because of the lack of current or comprehensive data; and whether there are other facts or issues that SBA should consider.

On September 10, 2014 (79 FR 53646), SBA published a proposed rule seeking comments on a number of proposals and issues. SBA invited comments on its proposals to increase employee based size standards for 30 industries and three sub-industries ("exceptions") and decrease them for three industries that are not part of NAICS Sectors 31–33, 42, or 44–45. SBA requested comments on a number of issues, including whether the size standards should be revised as proposed and whether the proposed revisions are appropriate. The Agency also sought feedback on its proposals to eliminate the Information Technology Value Added Resellers (ITVAR) sub-industry ("exception") under NAICS 541519 (Other Computer Related Services) and its 150-employee size standard and eliminate the Offshore Marine Air Transportation Services sub-industry or "exception" under NAICS 481211 and 481212 and Offshore Marine Services sub-industry ("exception") under NAICS Subsector 483 and their \$30.5 million receipts based size standard. The public was also welcome to comment on any other size standards that the Agency proposed retaining at their current levels. SBA's analyses supported lowering existing size standards for a number of

industries. However, as SBA pointed out in the proposed rule, lowering size standards would reduce the number of firms eligible to participate in Federal small business assistance programs and be counter to what the Federal government and SBA are doing to help small businesses. Therefore, SBA proposed to retain the current size standards for those industries and requested comments on whether the Agency should lower size standards for which its analyses might support lowering them. Finally, SBA also welcomed comments on various methodological issues, including the maximum and minimum levels of employees based size standards, industry and Federal contracting factors the Agency evaluates and/or suggestions on other factors that it should consider when evaluating or revising employee based size standards, and whether it should weigh each factor equally or it should weigh one or more factors more or less for certain industries.

#### Discussion of Comments

SBA received a total of 202 comments on the proposed rule, including 168 concerning the ITVAR size standard, 32 on the Environmental Remediation Services (ERS) size standard, and two relating to proposed size standards in general.

Of the 168 comments relating to the ITVAR size standard, five supported SBA's proposal to eliminate the ITVAR exception to NAICS 541519 and its 150-employee size standard, while the rest opposed it. Among those opposing the proposal, two also asked for a 60-day extension of the comment period. Of the 168 comments on the ITVAR size standard, four were from attorneys, one of which was on behalf of 13 small business ITVARs and three each on behalf of individual ITVAR businesses. One also provided a list of individuals who submitted concerns about the SBA's proposed rule to their Congressional representatives through a Web site that the company had developed.

Of the 32 comments on the ERS size standard, nine favored SBA's proposal to increase it from 500 employees to 1,250 employees, while 23 opposed it.

Among the two general comments, one supported SBA's proposed increases to size standards, while the other opposed it. These comments and SBA's responses are discussed below.

#### Comments on SBA's Proposal To Eliminate the ITVAR Exception

For Federal contracts that combine substantial services with the acquisition of computer hardware and software, in

2002, SBA proposed to establish a new "Information Technology Value Added Resellers (ITVAR)" sub-industry or "exception" category under NAICS 541519, Other Computer Related Services, with a size standard of 500 employees (67 FR 48419 (July 24, 2002)). In the final rule, SBA adopted the ITVAR exception under NAICS 541519, as proposed, with a size standard of 150 employees (68 FR 74833 (December 29, 2003)). Presently, the size standard for NAICS 541519 and other industries in NAICS Industry Group 5415, Computer Systems Design and Related Services, is \$27.5 million in average annual receipts.

As stated in Footnote 18 to SBA's table of size standards, for a Federal contract to be classified under the ITVAR exception and its 150-employee size standard, it must consist of at least 15 percent but not more than 50 percent of value added services. If the contract consists of less than 15 percent of value added services, it must be classified under the appropriate manufacturing industry. If the contract consists of more than 50 percent of value added services, it must be classified under the NAICS industry that best describes the principal nature of service being procured. In the September 10, 2014, proposed rule, SBA proposed to eliminate the ITVAR 150-employee size standard exception under NAICS 541519 because, as explained in the proposed rule and elsewhere in this final rule, it has created inconsistencies, confusion, and misuse. As stated above, SBA received a total of 168 comments, with five supporting SBA's proposal to eliminate the ITVAR exception and the rest opposing it.

#### *Comments Supporting SBA's Proposal To Eliminate the ITVAR Exception*

Four commenters explicitly supported SBA's proposal to eliminate the ITVAR exception. The commenters provided several reasons for their support of SBA's proposal. One stated that, due to its dual supply-services nature, the ITVAR exception has created misuse, confusion, and loopholes; removing it would help to ensure that procuring agencies comply with SBA's regulations and relevant case law. Others contended that the ITVAR exception allows larger businesses making hundreds of millions of dollars to bid as small businesses, thereby taking Federal opportunities away from true small businesses. One also added that the biggest problem is to validate whether the companies are performing 15–50 percent value added services. While stating that it is important to allow ITVARs to compete as small businesses for the Government

to receive fair and reasonable pricing, the fifth commenter argued that predominantly hardware and software contracts with little or no value added services are awarded under NAICS 541519 instead of the manufacturing NAICS code. These comments and SBA's responses are below.

#### *Comments That the ITVAR Exception Has Created Misuse*

One commenter argued that it has become common for procuring agencies to use the ITVAR exception to classify multi-agency contracts (MACs) and government-wide acquisition contracts (GWACs) to buy commercial off-the-shelf (COTS) IT hardware and software. In many cases, these contracts consist of less than 15 percent of value added services as required, and should have been classified under the appropriate manufacturing ("supply") NAICS code, the commenter noted. Another commenter contended that the biggest problem has been validating whether the companies are actually performing the 15–50 percent value added services and noted that, in most cases, they are not providing any service except for tacking on their 10–25 percent profit.

Another commenter mentioned that the real problem with NAICS 541519 is not the size standard itself, but the general misuse of the code altogether. It argued that IT hardware and software procurements in the billions of dollars that do not have "significant" value added services are purchased through NAICS 541519 instead of the manufacturing NAICS code. The commenter contended that entire GWACs (such as SEWP-IV/V, ECS-3 and new CIO-CS) are awarded under NAICS 541519 when the majority of items purchased are hardware and software only, with little or no value added services at all. The commenter urged SBA to stop the fraud, waste and abuse from contracting agencies using the wrong NAICS codes in order to get around the size standards. The commenter further asked SBA to stop allowing massive GWACs to be misclassified under NAICS 541519 so that everyone gets a fair chance to compete for those contracts.

#### *Comments That SBA's Proposal Would Have Minimal Impact on Small ITVARs*

One commenter noted that where the greatest portion of the contract value is for supplies and a manufacturing NAICS code is selected, the size standard for an IT reseller would be only 500 employees, even if the applicable size standard for the manufacturing NAICS code was higher. The commenter believed that, under these

circumstances, the elimination of the ITVAR exception would have a minimal impact on businesses below 150 employees, as those businesses would continue to qualify as small for IT supply contracts under the 500-employee nonmanufacturer size standard. The commenter acknowledged that while these businesses may be forced to compete with businesses between 150 employees and 500 employees, it disagreed with many commenters' arguments that eliminating the ITVAR exception would force them to compete with multi-billion dollar companies.

#### *Comments That the ITVAR Exception Has Created Loopholes*

One commenter argued that the ITVAR exception has created loopholes in SBA's regulations, country-of-origin requirements, and trade agreements. The commenter added that eliminating the ITVAR exception would help to ensure that the procuring agencies comply with applicable regulations and requirements. The commenter explained that SBA's regulations require procuring agencies to select the "NAICS code which best describes the principal purpose of the product or service being acquired." Where both products and services are being acquired, the commenter continued, the acquisitions must be classified according to the component which accounts for the greatest percentage of the contract value. Thus, the commenter stated, the procuring agency must identify whether the contract is primarily for the acquisition of services or supplies, and noted that the relevant case law (SBA No. SIZ-1295(1979)) also supports this. The solicitation must contain only one NAICS code and one size standard, and for a contract requiring the performance of a combination of work, a contracting officer must identify whether the contract is one for services, construction, or supplies for purposes of applying the performance of work requirements under the "limitations on subcontracting" provisions, the commenter concluded.

The same commenter argued that when agencies set-aside acquisitions using the ITVAR exception, it creates loopholes that allow agencies to bypass the NMR and limitations on subcontracting, which are intended to ensure that small business is the ultimate beneficiary of such acquisitions instead of a large original equipment manufacturers (OEMs) or systems integrators. The commenter further contended that because the ITVAR exception is part of a services NAICS code, the NMR does not apply to ITVAR

contracts even if, by definition, supplies are the majority component of those contracts. This allows IT resellers to provide the products under the set-aside acquisitions from large businesses, including foreign-based businesses, the commenter explained. The commenter further argued that restricting acquisitions for IT products to small businesses under the ITVAR exception also eliminates the country-of-origin requirements under both Trade Agreements and Buy American Acts, thereby granting non-designated countries an avenue to supply products to the U.S. government. Without the NMR, the requirement to furnish the end item of a U.S. small business is also eliminated, the commenter concluded.

#### *Comments That the ITVAR Exception Has Caused Adverse Impact on True Small Businesses*

One commenter noted that there are numerous large businesses hiding under the ITVAR exception, taking business away from true small businesses. The commenter added that the problem also exists in the subcontracting area where large businesses use these large value added resellers instead of true small businesses. Another commenter argued that the exception creates an unequal playing field as it allows companies making hundreds of millions of dollars a year to bid as small businesses on ITVAR contracts, essentially blocking true small businesses from those opportunities. These companies are much larger than true small businesses and have access to vast resources to assist them in their Request For Proposal responses, the commenter stated. Removing the exception will help level the playing field for companies bidding for opportunities under NAICS 541519, the commenter added. Another commenter contended that a small business is the one with \$27.5 million in sales, not the one with 150 employees. There are many companies serving the Federal market that win contracts based on having just 150 employees with annual receipts of \$200 million to \$800 million, the commenter continued. The commenter concluded by suggesting that to make the size standard more inclusive and see more participation of small businesses in the Federal market, the size standard for NAICS 541519 should be \$50 million in receipts.

The commenters supporting SBA's proposal shared the Agency's concerns that the exception has created inconsistencies, confusion, misuse, and loopholes. They explained that to treat ITVAR contracts as service contracts when, by definition, they are supply

contracts, is inconsistent with SBA's regulations that require procuring agencies, based on the principal purpose of the service or product being procured, to identify the procurements either as service contracts or as supply contracts, but not both. The commenters added that the dual service-supply nature of ITVAR contracts has also created confusion with respect to compliance with SBA's regulations, such as limitations on subcontracting and the NMR. They contended that, given the inapplicability of the NMR for the exception, ITVARs are allowed to provide the products under the set-aside acquisitions from large businesses, including OEMs and foreign-based businesses, thereby defeating the very intent of the small business set-aside programs. The commenters also shared SBA's concerns that the agencies use the ITVAR exception and its 150-employee size standard to acquire computer hardware and software with limited value added services, which could have been classified under the manufacturing NAICS codes, thereby requiring them to comply with the NMR.

#### *SBA's Response*

Regarding commenters' concerns about the misuse of NAICS 541519, SBA agrees that the ITVAR exception has allowed Federal agencies to use NAICS 541519, instead of manufacturing NAICS codes, for computer hardware and software procurements that do not have "significant" value added services. SBA's proposal to eliminate the exception was intended to address this issue.

However, SBA disagrees with the suggestion that the size standard for NAICS 541519 should be increased to \$50 million in receipts to increase small business participation in the Federal market. The results of industry and Federal procurement data published in the proposed rule (76 FR 14323 (March 16, 2011)) and final rule (77 FR 7490 (February 10, 2012)) on NAICS Sector 54 supported \$25.5 million in average annual receipts (now \$27.5 million due to inflation adjustment) as the size standard for all industries in NAICS Industry Group 5415, including NAICS 541519. Data do not support the suggested \$50 million as the size standard for NAICS 541519, and SBA is also concerned that such a high size standard would negatively impact the ability of small businesses below the current size standard to compete for Federal opportunities. As part of its quinquennial comprehensive review of size standards as required by the Jobs Act, SBA will review all size standards in the coming years and make necessary

adjustments to reflect the latest industry and Federal market data.

#### *Comments Opposing SBA's Proposal To Eliminate the ITVAR Exception*

Most commenters argued SBA's proposal to eliminate the ITVAR exception and its 150-employee size standard and apply the \$27.5 million receipts based size standard to ITVAR contracts would have negative impacts on both many small businesses and on Federal programs. Many contended that a receipts based size standard is not appropriate for the ITVAR industry and SBA's justification to establish the ITVAR exception and the 150-employee based size standard in its 2003 final rule is still valid. A large majority of the commenters questioned the SBA's conclusions based on the 2007 Economic Census data that the proposed rule would have a minimum impact on businesses between the 150-employee size standard and the \$27.5 million receipts based size standard. Many contended that SBA did not provide in the proposed rule a detailed analysis of the ITVAR industry and the data to support its reasons that the ITVAR exception has created inconsistencies, confusion, and misuse. Many stated that there has been no material change in the ITVAR industry since the 2003 final rule, thereby a change to the size standard is not warranted. A few commenters argued that the proposed rule also violates the statutory requirements under the National Defense Authorization Act for Fiscal Year 2013 (NDAA 2013), Regulatory Flexibility Act (RFA) and Small Business Regulatory Enforcement Fairness Act (SBREFA), while a few others also argued the rule is also against the intent of the Jobs Act. One commenter argued that SBA's proposal to eliminate the ITVAR exception runs counter to its decision to retain all other exceptions in other industries. Several commenters suggested that SBA should not proceed with the proposal until it conducts a detailed analysis of the ITVAR industry, while others advocated alternative measures to address the issues of inconsistencies, confusion, and misuse instead of eliminating the exception. These comments and SBA's responses are detailed below.

#### *Comments That the Proposed Rule Would Have Adverse Impacts on Small Businesses*

Most commenters argued that the SBA's proposed rule to eliminate the ITVAR exception and its 150-employee size standard (some referred to Footnote 18) and apply the \$27.5 million receipts based size standard for NAICS 541519

to ITVAR contracts would have a devastating impact on many small businesses that are below the 150-employee size standard, but above the \$27.5 million receipts based size standard. The commenters added that, if the ITVAR exception and its 150-employee size standard were eliminated, numerous companies (some said thousands) would become ineligible to compete for small business set-asides or reserves programs under DHS's FirstSource II, NASA's SEWP V and other GWAC or MAC vehicles because they easily exceed the \$27.5 million receipts based size standard for NAICS 541519 due to high volumes and costs of products/goods sold under ITVAR contracts.

Many commenters argued that, without Footnote 18, the proposed rule would subject ITVAR firms to the \$27.5 million receipts based size standard for NAICS 541519. The commenters claimed the proposed rule would make those firms lose their small business status, thereby forcing them to compete for computer hardware and software contracts with larger IT companies (including OEMs) with 500 employees to 1,000 employees and receipts in billions of dollars. Some commenters noted this would benefit large contractors, as small ITVARs do not have resources to compete with those large companies. One commenter acknowledged that small ITVARs are able to compete against large companies with hundreds of thousands of employees and against OEMs that sell IT products and services directly to the Government. However, several argued that this would reduce their ability to serve government customers or would even potentially force them out of the Federal IT marketplace entirely. Some commenters noted this would force them to downsize their businesses, which may limit business growth and small business job creation. A few other commenters claimed this would make many IT service companies ineligible for the type of contracts they have been performing over the years.

Numerous commenters stated that many small ITVARs seeking opportunities in the Federal IT marketplace do a significant amount of Federal business utilizing the ITVAR exception under NAICS 541519. They added that a considerable amount of money is allocated to the NAICS 541519 exception and it is not fair to take those opportunities away from small businesses. The proposed change, if adopted, the commenters indicated, would be detrimental to those businesses and Federal agencies that depend on them, because many small

ITVARs would no longer be able to compete for Federal opportunities under NAICS 541519 as small businesses. Some seemed concerned that the loss of revenue would destroy many small ITVARs and force them to close their businesses, while others noted that this would have a negative impact on employment and economic growth in the region, including the Historically Underutilized Business Zones (HUBZones).

Some commenters stated that, without Footnote 18, ITVAR contracts would be classified either as a services contract under the \$27.5 million receipts based size standard or as a supply contract under the NMR. They claimed that small ITVARs would become ineligible for services contracts because they exceed the receipts based size standard and for supply contracts, they would have to compete with larger businesses. One commenter noted that currently the ITVAR exception benefits ITVAR firms in three ways: (i) it enables them to sell supplies as a small business concern without the NMR, compliance of which is complicated and cumbersome, (ii) it shields the firms from competition with firms that have between 151 employees and 500 employees, and (iii) it has enabled ITVARs to sell some services as small businesses even though they exceed the receipts based size standard. The commenter argued that the proposed rule would wipe out all these benefits. As all IT supplies contracts would be under the NMR, ITVARs would have to compete with much larger companies for small business supplies contracts. In addition, ITVARs that exceed the receipts based size standard, could not compete for small business services contracts.

#### *SBA's Response*

SBA disagrees with commenters' interpretation that with the proposed elimination of the ITVAR exception and its 150-employee size standard, many businesses would lose their small business status because they exceed the \$27.5 million receipts based size standard associated with NAICS code 541519. These comments indicate that there was some confusion concerning the impact of SBA's proposal, if adopted, on current small ITVARs. Many commenters incorrectly believed that, if the exception is eliminated, all contracts that currently use the ITVAR exception and 150-employee size standard would be subject to the \$27.5 million receipts based size standard for NAICS 541519 and that many ITVARs with 150 or fewer employees would lose their small business status and hence become ineligible to bid on those

contracts because they have annual receipts above \$27.5 million. Some misunderstood SBA's proposed elimination of the ITVAR exception to change the size standard for procurement of IT products from 150 employees to \$27.5 million in average annual receipts. As stated in the proposed rule, if the ITVAR exception is eliminated, all ITVAR contracts would be reclassified under the employee based size standard for the manufacturing industries or under the 500-employee nonmanufacturer size standard. By definition, the ITVAR exception is for contracts that are primarily supply contracts, with some services. The \$27.5 million receipts based size standard is for contracts that are primarily service contracts, which is not the case under the exception. Accordingly, for IT supply contracts using the manufacturing size standards, the 500-employee nonmanufacturer size standard, and other elements of the NMR, would also apply. Thus, all firms that currently qualify under the 150-employee ITVAR size standard would continue to qualify for such contracts as small businesses under the 500-employee nonmanufacturer size standard.

In response to concerns that by eliminating the ITVAR exception and reclassifying ITVAR contracts under the manufacturing NAICS codes it would mainly benefit large companies with 500 employees to 1,000 employees, SBA analyzed the FPDS-NG data on IT supply contracts under NAICS Industry Group 3341, Computer and Peripheral Equipment Manufacturing. For fiscal years 2012-2014, the results showed that about 76 percent of dollars awarded to small businesses under NAICS Industry Group 3341 went to firms with 150 or fewer employees. Thus, the results do not support the argument that IT supply contracts would be dominated by larger companies if they are reclassified under the manufacturing NAICS codes. Additionally, while many commenters expressed concerns for having to compete with large companies if the exception is eliminated, several also noted that small ITVARs have capabilities and resources to outcompete large companies and to provide the best solution to the government. ITVARs would continue to benefit from those attributes if ITVAR contracts were reclassified under the manufacturing NAICS codes.

Some commenters contended that the proposed rule would cause thousands of small businesses to lose their small business status and become ineligible to compete for ITVAR contracts as small businesses. SBA disagrees for three

reasons. First, the commenters did not provide any data or data sources to support their claim that thousands of businesses will be affected. Second, as explained above, no ITVAR firms below 150 employees would actually lose their small business status under the proposed rule, because they would continue to qualify to compete for those contracts as small businesses under the 500-employee nonmanufacturer size standard. Third, SBA reviewed commenters' data on companies receiving contracts under various GWACs and tasks orders under the ITVAR exception and similar data that it compiled from other GWACs (such as GSA's Schedule 70 SIN 132-8) using FPDS-NG for fiscal years 2012-2014. The data showed that, of about 260 firms receiving contracts under those GWACs during fiscal years 2012-2014, about 60 or 25 percent had more than the \$27.5 million in receipts but fewer than 150 employees. However, the proposed rule would have no impact on their small business status under the receipts based size standard for NAICS 541519. Moreover, of total contract dollars received by firms between the \$27.5 million receipts level and 150-employee level during fiscal years 2012-2014, nearly half (46 percent) were from contracts they received under NAICS codes other than NAICS 541519. SBA agrees that, if the exception were eliminated, firms that currently qualify as small for ITVAR contracts would have to compete with larger companies with between 150 employees and 500 employees under the nonmanufacturer size standard, but the relevant data does not support that the impacts would be as detrimental as those characterized by the commenters. However, this was an important factor for the SBA's decision to maintain the current 150-employee size standard in this final rule.

In response to concerns that the proposed rule would wipe out the benefit the ITVAR exception provides to ITVAR firms by enabling them to sell supplies under small business set-aside contracts without the NMR, SBA believes that, similar to all other small business supply acquisitions, all small business acquisitions for computer hardware and software, including those classified under the ITVAR exception must also comply with the NMR. The arguments that the compliance with the NMR is complicated and cumbersome are not valid reasons for not following statutory provisions. It should be noted that the proposed rule would have no impact on qualifying as small for contracts that are primarily for services classified under the receipts based size

standard for NAICS 541519. ITVAR firms that exceed the receipts based size standards currently would continue to be ineligible for IT services contracts, regardless of whether the ITVAR exception is retained or eliminated. Thus, SBA disagrees with the argument that the proposed rule would make ITVAR firms lose their eligibility to compete for IT services contracts under the receipts based size standard.

#### *Comments That the Proposed Rule Would Have Adverse Impacts on Federal Agencies*

Numerous commenters noted that Federal agencies set aside billions of dollars for small businesses under NAICS 541519 using the ITVAR exception and 150-employee size standard. The commenters identified several multi-year, multiple award IDIQ contracts that are currently set aside to small businesses to procure computer hardware and software and services, including DHS' FirstSource, Army's ITES-3H, NASA's SEWP, and NIH's CIO-CS programs. They argued that SBA's proposed rule would have a devastating impact on those Federal programs and small businesses that depend on them.

Several commenters argued that SBA's proposal to eliminate the 150-employee size standard and retain the \$27.5 million receipts based size standard would render ineligible the vast majority of small businesses currently performing ITVAR contracts under the above programs. According to the commenters, there would not be enough qualified small businesses under the \$27.5 million receipts based size standard to perform large volumes of complex ITVAR contracts. This would force, the commenters claimed, the agencies to procure such contracts directly through OEMs or classify them under NAICS codes where businesses with 1,000 or 500 employees are considered small. Some commenters contended that the SBA's proposed change would curtail the Government's ability to count on a reliable small business industrial base to provide these IT products and services, while others claimed that it would eliminate significant depth of products and services the Government receives from small ITVARs.

While some commenters seemed wary of having to compete with OEMs if the exception is removed, many others noted that most ITVARs have relationships with hundreds of OEMs, thereby enabling them to obtain the most competitive pricing for a given product and provide the best solution to a customer need by combining the best

mix of products from multiple OEMs. One commenter stated that approximately 75 percent of Federal sales of many leading OEMs are fulfilled through their ITVAR partners. The same commenter argued that, without Footnote 18, this value-added ability of ITVARs will be lost, because the majority of ITVARs will no longer qualify as small businesses and likely be unable to compete against large businesses.

Several commenters argued that SBA's proposal, if adopted, would decrease the pool of responsible and qualified contractors for ITVAR acquisitions, as companies below the \$27.5 million receipts based size standard lack financial resources, technical capabilities, experiences, and qualified personnel to meet the requirements. The commenters noted that the receipts based size standard would limit the government's ability to receive competitive pricing for a wide variety of products and services, because businesses at the \$27.5 million receipts level have no buying power to leverage OEM cost down and qualified personnel to obtain the OEM certification to be able to resell, obtain discounts and provide authorized services. Thus, the commenters claimed, the companies with annual receipts of \$27.5 million cannot effectively compete with large companies for Federal IT requirements, but ITVARs with higher revenue can. Some commenters claimed that the ITVARs have the revenue base and creditworthiness to purchase millions or tens of millions of dollars of products and that the companies with less than \$27.5 million revenue are unable to obtain credit facilities necessary to purchase the product component of the solution. Several commenters argued that, if ITVAR contracts are subject to the \$27.5 million receipts based size standard, agencies would not be able to use NAICS 541519 to procure a mix of services and large volumes of computer hardware and software.

Some commenters argued that the ITVAR exception has helped the Federal government to obtain information systems to improve efficiency and reach its goals. Small ITVARs provide, they explained, integrated solutions to complex IT challenges, allowing agencies to focus on their missions, and eliminating the ITVAR exception would negatively impact the delivery of these solutions and thus the missions of the agencies. One commenter claimed that small ITVARs play a significant role in maximizing Federal small business utilization, while another noted that the elimination of Footnote 18 will negatively impact the recent progress

made toward meeting the Federal government small business contracting goal.

#### *SBA's Response*

SBA does not agree with the commenters' contention that the proposed rule would have a devastating impact on Federal programs and small businesses that depend on them. As stated earlier in this preamble, under the proposed rule, not a single ITVAR firm below 150 employees would lose its small business status to qualify for ITVAR contracts as small businesses. Moreover, a size standard change would have no impact on small business status for current contracts; it would only affect future contracts. If Footnote 18 were removed as proposed, ITVAR contracts, which are by definition supply contracts, would be reclassified under a higher manufacturing size standard along with the 500-employee nonmanufacturer size standard. As a result, all currently small ITVARs would continue to qualify as small businesses to provide exactly the same products and services they are currently providing to the Federal government under the ITVAR exception.

SBA also does not agree with the concerns that, under the proposed rule, there would not be enough qualified small businesses below the \$27.5 million receipts based size standard for the Government to choose from to perform large volumes of complex ITVAR contracts. First, if the exception is removed, ITVAR contracts would be reclassified under one of the manufacturing NAICS codes, with the higher manufacturing size standard along with the 500-employee nonmanufacturer size standard, not the \$27.5 million receipts based standard for NAICS 541519. Second, because additional ITVARs between 150 employees and 500 employees could also compete on those contracts as small businesses, there would actually be more small businesses, not fewer, available for the agencies to choose from. Therefore, SBA does not believe that the proposed rule would necessarily lead the agencies, due to lack of small businesses, to procure IT products directly from OEMs or large businesses. SBA also does not believe that this would necessarily have any impact on quality or depth of products or services the government receives. Every year the agencies allocate billions of dollars to the manufacturing NAICS codes and NAICS 423430 (albeit incorrectly) to procure computer hardware and software. For example, during fiscal years 2012–2014, the Federal government procured computer

hardware and software and some services valuing nearly \$4 billion annually using NAICS Industry Group 3341 and NAICS 423430. Almost half (48%) of those dollars were awarded to small businesses, of which nearly 75 percent went to firms with fewer than 150 employees. Even with the ITVAR exception, agencies have used NAICS Industry Group 3341 and other manufacturing NAICS codes to classify IT supply acquisitions under various GWACs. For example, during fiscal years 2012–2014, NAICS Industry Group 3341 accounted for almost all contract dollars under NIH's ECS–3 and nearly three-fifths of dollars awarded under Army's ITES–2H, and nearly 15 percent under NASA's SEWP IV. Similarly, all contracts under Air Force's NETCENTS–2 were classified under NAICS 334210. The data on companies receiving contracts under various GWACs that utilized the ITVAR exception and 150-employee size standard does not appear to support the commenters' argument that the companies at or below the receipts based size standard lack financial resources and personnel to perform ITVAR contracts. During fiscal years 2012–2014, there were 155 GWAC contracts (*i.e.*, with dollar awards) set aside for small businesses using the ITVAR exception for a total of \$5.4 billion in dollars obligated. Small businesses below the receipts based size standard accounted for more than 70 percent of those contracts and 40 percent of dollars awarded.

SBA does not agree with the argument that by losing small business status, under the proposed rule, ITVARs would also lose the relationships they have with OEMs to be able to provide the Government with best mix of products at most competitive prices. As explained elsewhere in this rule, even if the exception is removed, because they would maintain their small business status for ITVAR contracts under the 500-employee nonmanufacturer size standard, there is no reason why they would not be able to maintain their relationship with OEMs and use that in future contracts. While SBA recognizes that the relationship ITVARs have with OEMs plays an important role in the Federal IT marketplace, the Agency is concerned with the negative impact it could have on many small manufacturers of various IT products, especially given the fact that, according to one commenter, almost 75 percent of Federal sales of many leading OEMs are fulfilled through their ITVAR partners.

As discussed earlier, if the exception is eliminated, because ITVAR contracts would not be subject to the \$27.5

million size standard that applies to services contracts under NAICS 541519, SBA disagrees with the commenters' arguments that the proposed rule would decrease the pool of qualified ITVAR contractors. However, these arguments support SBA's concerns that having the ITVAR exception under the services NAICS code and allowing agencies to include significant services in ITVAR contracts may have negatively impacted companies below the receipts based size standard by forcing them to compete for small business contracts with companies that have much higher revenue base and financial resources.

With respect to the commenter's argument that the ITVAR exception plays a role in maximizing small business participation in government contracting and meeting the Federal government small business contracting goal, SBA considers the share of contract dollars awarded to small businesses relative to their share in the overall industry as one of the primary factors in determining size standards for specific industries. However, whether the government is meeting its small business goal is not considered as a factor because that is influenced by a myriad of factors, mostly unrelated to size standards. Further, agencies can request that SBA waive the NMR, which would enable the agencies to set aside the very same acquisitions for small business concerns, under the manufacturing NAICS code and utilizing the nonmanufacturer size standard of 500 employees. Moreover, class waivers already exist for a wide range of IT products under computer and peripheral equipment manufacturing related NAICS codes that may cover the types of IT products purchased using the ITVAR exception.

#### *Comments That the Proposed Rule Is Contrary to SBA's Previous Rules*

Several commenters argued that the SBA's proposed rule is contrary to its justification and analysis it provided in its 2002 proposed rule (67 FR 48419 (July 24, 2002)) and 2003 final rule (68 FR 74833 (December 29, 2003)) for establishing the ITVAR exception and 150-employee based size standard, as well as its 2011 proposed rule (76 FR 14323 (March 16, 2011)) and 2012 final rule (77 FR 7490 (February 10, 2012)) on NAICS Sector 54 (Professional, Scientific and Technical Services), where the Agency reaffirmed the 150-employee size standard for the exception. The commenters argued that the SBA's 2002/2003 and 2011/2012 rationale that an employee based size standard, not the receipts, was an accurate and appropriate measure of

small business size for ITVARs is even more appropriate today. One commenter stated that selling a combination of computer hardware and software and services still exists as a distinctive industry category and that it should be retained. Another reiterated several reasons SBA provided when establishing the exception in its 2002/2003 rulemaking and argued they are still valid today. First, the ITVAR sub-industry serves the Federal government's preference to go to a single source to obtain IT equipment and supporting services. Second, most acquisitions are for numerous IT products, and it is unrealistic to expect one manufacturer to produce all of the required items. Third, IT contracts often require the contractor to customize the computer hardware or install specialized software to meet an individual user's needs. Fourth, the new industry category enables agencies to better utilize small business preference programs for their IT acquisitions.

Several commenters were concerned that SBA did not provide any explanation or reason why the justification, rationale, or industry analyses provided in its 2002/2003 and 2011/2012 rulemakings no longer apply in 2014. Commenters suggested SBA provided no facts or reasons showing changes in the ITVAR industry and Federal IT procurement to justify its proposal to eliminate the employee size standard in the current proposed rule. Some commenters argued that because SBA is not able to provide a convincing justification for its proposed removal of the ITVAR exception it established in the 2002/2003 rulemaking, it should retain it. Still some complained that SBA's decision to establish the ITVAR sub-industry and its 150-employee size standard in 2003 was based on a detailed analysis of market and industry data, but its current proposal to repeal it without similar analysis or other persuasive reasons cannot be justified.

#### *SBA's Response*

As the result of the review of its small business regulations and size standards as required by Executive Order 13563 and the Jobs Act, SBA now believes that the two key provisions of the 2003 final rule are inappropriate, which SBA is attempting to amend through this rulemaking.

First, the Agency's decision in its 2002/2003 rulemaking to place the ITVAR exception for supply contracts as a sub-industry category under NAICS 541519, a services NAICS code, is inconsistent with NAICS industry definitions. Under NAICS, as also noted in the 2003 final rule, ITVARs are

primarily merchant wholesalers or distributors of the computer hardware and software products with a very different production function when compared to firms in NAICS 541519. The analyses many commenters provided to support their position that ITVAR firms have very different revenue and cost structure as compared to their counterparts in NAICS 541519 also demonstrate that including the ITVAR exception under NAICS 541519 is inconsistent with differences in economic realities between the ITVAR industry and NAICS 541519. Additionally, as discussed elsewhere in this rule, SBA now finds that its approach to creating the ITVAR industry by combining parts of NAICS Industry Group 5415 and NAICS 423430 was also not correct.

Second, the 2003 final rule defined ITVAR contracts as services contracts, even if services, by definition, never account for more than 50 percent of total values of such contracts, thereby exempting them from the manufacturing performance requirements and NMR. These rules are critical to ensure that small businesses are the ultimate beneficiaries of small business set-aside contracts. The statutory manufacturing performance requirements and NMR provisions apply to all supply contracts, and do not exempt information technology acquisitions.

SBA disagrees with the commenters' argument that the proposed rule is against its 2011/2012 rulemaking on NAICS Sector 54. It should be noted that SBA's decision to retain the 150-employee based size standard for the ITVAR exception under Footnote 18 in its 2011/2012 rulemaking was not based on the analysis of the relevant industry and market data. The SBA's decision to retain the 150-employee size standard was only temporary until the Agency reviewed employee based size standards. In the same rule, SBA had also retained the employee based size standards for NAICS codes 541711 and 541712, which the Agency proposed to change in the September 10, 2014 proposed rule.

SBA does not believe that reclassifying ITVAR contracts under the manufacturing NAICS codes would require the agencies to make significant changes to the ways they acquire computer hardware and software using the ITVAR exception, except that the agencies would be required to comply with the NMR. The proposed rule would have eliminated the ITVAR sub-industry only as an exception to NAICS 541519, but would not have eliminated the ITVAR industry in its entirety from the Federal IT market. As explained

elsewhere in this rule, the proposed rule, would only have led to reclassifying ITVAR contracts using applicable manufacturing NAICS codes in which ITVAR firms would continue to qualify under the 500-employee nonmanufacturer size standard. The nature of the work under ITVAR contracts would remain intact. First, current small ITVARs would continue to qualify to participate in Federal IT market as small businesses and provide a combination of computer hardware and software and services to the Federal government. Second, under the NMR, Federal agencies would continue to be able to procure multiple products through a single distributor or reseller instead of having to go to individual manufacturers of different products. Third, classifying acquisitions of IT products under the manufacturing NAICS codes along with a higher 500-employee nonmanufacturer size standard should, in fact, help, not hinder, Federal agencies to better utilize small business set-aside programs for acquisitions of IT supplies, because agencies would have a larger pool of small businesses to draw from to meet their needs.

#### *Comments That the Proposed Rule Lacks Industry Data and Analysis*

Many commenters contended that the proposed rule does not provide the required industry analysis and latest economic data to justify the removal of the ITVAR exception and its 150-employee size standard similar to what SBA provided in its 2003 final rule to establish the exception and the size standard. Two commenters argued that the proposed rule does not provide the required analyses of the industry and competitive environment as required by the statute in support of the proposed elimination of the ITVAR exception. One of those two commenters also contended that the proposed rule does not provide the detailed impact analysis of the proposed change to the ITVAR size standard as required by the Regulatory Flexibility Act (RFA). The same commenter argued that SBA's rationale that the ITVAR exception has resulted in inconsistencies, confusion, and misuse does not in itself justify its elimination that will have a substantial impact on a significant number of small businesses. Several commenters argued that the proposed rule provides no discussion, analysis, data, or valid reasons as to why the SBA now considers the proposed approach to be appropriate, when in 2002–2003 it established the ITVAR exception and considered the receipts based size standard not appropriate for ITVARs.

Some commenters noted that the proposed rule is based on unfounded conclusions and represents an error in judgment that would have dire consequences for many small businesses and a number of government programs.

Many commenters challenged the results from the 2007 Economic Census data that SBA included in the proposed rule that “150 employees is more or less equivalent to \$27.5 million receipts in NAICS 541519 and that more than 99 percent of firms below the 150-employee level will continue to qualify as small under the \$27.5 million receipts based size standard.” Using a sample of small ITVARs awarded contracts under the various GWAC vehicles (such as DHS’s FirstSource II, Air Force’s NETCENTS–2, and NASA’s SEWP V), one commenter countered the Economic Census results that the average size of small ITVAR companies was about \$48 million in receipts and 45 employees and that more than 50 percent of ITVARs between \$27.5 million and 150 employees would lose their small business status under the SBA’s proposed change. The same commenter also stated that 12 of 13 of its small ITVAR clients had receipts in excess of \$27.5 million (average \$123 million) and averaging only 50 employees. Using a scenario analysis with various percentages of value added services and the average wage for the IT sector, another commenter demonstrated that 150 employees is not equivalent to \$27.5 million in receipts. Another commenter countered the Economic Census results by saying that virtually all ITVARs have annual receipts exceeding \$27.5 million, while employing significantly fewer than 150 employees and in many cases fewer than 50. Similarly, another contended that the Economic Census (but did not specify which Economic Census) shows 72 percent of ITVARs, not 99 percent, would qualify as small under the \$27.5 million receipts based size standard. Several others also claimed that SBA’s statements are not supportable, but did not provide or suggest the specific data to support their claims.

A number of commenters dismissed the above results as being based on the outdated data, arguing that the 2007 economic data has no relevance for contracts awarded in 2014 under NAICS 541519, especially to ITVAR contracts awarded under the 150-employee size standard. Some argued that SBA’s results only apply to IT service provider firms in NAICS 541519, but not to ITVAR firms, while others contended that SBA provides no other recent economic data to support its

conclusions from the 2007 Economic Census.

Other commenters also challenged SBA’s seemingly conflicting statements in the proposed rule. For instance, in one place, SBA stated that, based on 2007 Economic Census, 99 percent of small ITVARs will retain their small business status under the receipts based size standard, while elsewhere in the rule it acknowledged that the Economic Census do not provide the data to analyze sub-industry categories or exceptions. The commenters argued that this shows SBA lacks an understanding of the economic realities and characteristics of the ITVAR industry and has no knowledge of the number of small businesses receiving contracts under the 150-employee size standard. This led, as some commenters contended, SBA to come to the faulty conclusion that 99 percent of firms below the 150-employee size standard would continue to qualify as small under the \$27.5 million receipts based size standard.

#### *SBA’s Response*

SBA’s proposal to remove the ITVAR exception was not driven by the analysis of the industry data. Rather, the proposal was primarily driven by the need to eliminate obvious inconsistencies, confusion, and misuse that the ITVAR exception has created. In response to the comments, elsewhere in this final rule, SBA has provided a detailed analysis of data on firms receiving ITVAR contracts. Regarding the comment relating to the lack of the impact analysis of the proposed rule, as part of regulatory impact analysis as required by Executive Order 12866 and initial regulatory flexibility analysis (IRFA) as required by the RFA, SBA provided the estimate for the number of small businesses impacted by changes to industry size standards covered by the proposed rule, along with the estimates on the impacts on small business participation in Federal procurement and SBA financial assistance programs. As in all previous proposed and final rules on size standards for other NAICS sectors, SBA only provided the aggregate estimates of the impacts for all affected industries, instead of separate estimates for each industry or sub-industry.

As explained in the proposed rule, the Economic Census data SBA uses for size standards analysis are limited to the 6-digit NAICS industry codes and hence do not provide the data for sub-industry categories or “exceptions,” including the ITVAR sub-industry. Given the lack of data specific to the ITVAR sub-industry, to get some general sense

about the potential impact the proposed rule would have on current small ITVARs, SBA analyzed the 2007 Economic Census data for NAICS 541519 because the ITVAR exception is under that NAICS code. That analysis suggested that 150 employees is more or less equivalent to \$27.5 million for firms in that industry. The results also showed that 99 percent of firms with 150 or fewer employees would have receipts below \$27.5 million. SBA agrees with the comments that these results most likely apply to all firms within NAICS 541519 and not necessarily to ITVAR firms, given the differences in economic characteristics between the two. In response to the comments, SBA analyzed the data on firms receiving ITVAR contracts and other contracts under NAICS 541519 and Economic Census data for NAICS 541519 and 423430. The results, as detailed elsewhere in this final rule, would support the commenters’ claims that the results for NAICS 541519 do not provide an accurate description of ITVAR firms. The results would also support SBA’s assessment that it would be inappropriate to include the ITVAR sub-industry as an exception to NAICS 541519.

With respect to the commenters’ challenge to the SBA’s statement on the equivalence between 150 employees and \$27.5 million receipts, it should be noted that, using the 1997 Economic Census data, SBA had reached a similar conclusion in the 2003 final rule that 150 employees is equivalent to the average number of employees of firms under the then \$21 million receipts based size standard for computer related services (NAICS Industry Group 5415) (68 FR 74833). In fact, the discussion in the 2003 final rule indicates that the equivalence between the receipts based size standard at that time and 150-employee level was the key factor for establishing the 150-employee size standard for the ITVAR exception, although the vast majority of the commenters on the SBA’s proposed 500-employee size standard had suggested using a 100-employee size standard. Moreover, given the equivalence between 150 employees and the then \$21 million size standard for NAICS Industry Group 5415, in the 2003 final rule, SBA even contemplated using the same receipts based size standard for the ITVAR industry.

Regarding some commenters’ concerns that SBA’s results based on the 2007 data are outdated and have no relevance to contracts awarded in 2014, it should be noted that the 2007 Economic Census is the latest and most comprehensive industry data available

to the Agency when the proposed rule was developed and this final rule was prepared. The data on the more recent 2012 Economic Census tabulation will not be available until late 2016. It should also be noted that the SBA's analysis in the 2003 final rule that established the 150-employee based size standard for ITVARs was also based on the similarly outdated 1997 Economic Census data. As discussed elsewhere in the rule, several commenters noted that there has been no material change in the ITVAR industry since the 2003 final rule, which bodes well with using the 2007 data. Many commenters criticized the 2007 Economic Census data as outdated, but except for a limited sample data on companies receiving ITVAR contracts under some GWACs or some general suggestions to look at the data on FPDS-NG and USASpending, commenters really did not provide or suggest alternative data to evaluate the ITVAR industry.

In response to the comments, using the data from small business goaling reports and FPDS-NG for fiscal years 2012-2014 (the latest available when the final rule was prepared), SBA analyzed receipts and number of employees for firms receiving contracts under various GWACs and task orders that used the ITVAR exception. The results showed, of about 260 such firms, about 60 firms had 150 or fewer employees and receipts above \$27.5 million. Although this figure is higher than the one suggested by the 2007 Economic Census, this is quite small relative to some commenters' claim that thousands of currently small ITVARs exceed \$27.5 million and lose their small business status under the proposed rule. More importantly, as stated elsewhere in this final rule, under the proposed rule, none of the firms between the \$27.5 million receipts level and 150-employee employee level would actually lose their small business status because they would continue to qualify as small for the IT supply contracts under the 500-employee nonmanufacturer size standard. In fact, based on the same data, the majority of ITVARs below 150 employees and above \$27.5 million receipts were already found to have received IT supply contracts as small businesses under the 500-employee nonmanufacturer size standard.

#### *Comments That SBA Provides No Evidence for Its Rationale*

Several commenters claimed that SBA provides no evidence, facts, or data to support its justification to eliminate the ITVAR exception because it has created inconsistencies, confusion, and misuse.

One commenter noted that there has been no single investigation from the GAO or SBA's Inspector General to substantiate the SBA's position. Others argued that to eliminate the ITVAR exception, SBA did not provide similar data and analyses that the Agency provided in its 2003 final rule.

Several commenters dismissed SBA's justification for the proposed rule that the ITVAR exception has created some inconsistencies, confusion, and misuse as being vague, conjectural, and speculative. In response to SBA's statement about the confusion due to the inability of contracting officers to identify size standards exceptions in FPDS-NG, some commenters suggested that SBA should pursue modification of FPDS-NG, while others suggested adding an independent ITVAR NAICS code.

With respect to the SBA's statement that in many cases Federal agencies have applied the 150-employee size standard, instead of the receipts based size standard, for contracts that were primarily for services, thereby benefitting more successful or mid-sized companies at the expense of those below the receipts based size standard, one commenter noted that misapplications of NAICS codes are not limited to Footnote 18 and that SBA did not present any evidence to show that Footnote 18 is particular cause of error, while another argued that SBA did not provide the data to support its argument. The commenters suggested that training and guidance to procurement personnel would be a better remedy than eliminating the exception. On the same issue, one commenter noted that misuse is not the valid reason to eliminate the exception, because it is a training issue and it is SBA's responsibility to ensure that the exception is used correctly.

With regard to the SBA's statement that firms may or may not be eligible as small for the exact purchase simply based on the contracting officer's selection of the NAICS code and size standard, the commenter countered that this is not an issue limited to procurements using Footnote 18. The commenter argued that this is the nature of the Federal acquisition process, which gives discretion to contracting officers in selecting the NAICS code and the size standard.

With respect to the SBA's assessment that the combination of services and supplies in an acquisition is not unique to the IT industry, one commenter claimed that the general principle is that agencies classify procurements based on the principal purpose of the acquisition and that regardless of the relatively high

dollar value of the IT product component of an ITVAR acquisition, the product is not the principal purpose of these acquisitions. Responding to the same issue, another commenter contended that SBA fails to account for numerous ways the Federal government treats IT purchases differently than other types of purchases, as reflected in the TechFAR. The same commenter went on to challenge the proposed rule for not addressing the concerns that led to the creation of the ITVAR size standard that still exist today.

In response to SBA's language that it is also unclear from the terms of the exception itself whether a contract using the ITVAR 150-employee size standard should be classified as a service contract or a supply contract, one commenter noted that with or without Footnote 18, NAICS 541519 is a service NAICS code and that, according to the 2003 rule, the NMR does not apply to small business, 8(a), or HUBZone set-aside contracts classified under the ITVAR exception.

Several commenters also challenged the SBA's statement that the lack of data on characteristics of firms in ITVAR activities in the Economic Census tabulation and FPDS-NG to evaluate the current 150-employee size standard also justifies the proposal to eliminate the ITVAR sub-industry category by arguing that the lack of data or government inability to collect or track the data are not valid reasons for the elimination of the exception or changing industry size standards. Some commenters criticized the Agency for making no attempt to obtain the necessary data, while others contended that the lack of data to support any change should mean that SBA should take no action in the first place. For the data, some commenters suggested either splitting the NAICS 541519 or creating a new NAICS code for ITVARs, while others suggesting reproducing the analysis from the SBA's 2002/2003 rulemaking.

#### *SBA's Response*

As stated elsewhere in this rule, SBA's proposal to remove the exception was not driven by the analysis of the Economic Census data. Rather SBA's proposal was primarily driven by the need to eliminate inconsistencies, confusion, and misuse that the ITVAR exception has created. In response to the comments, elsewhere in this rule, the Agency has provided a detailed analysis of the ITVAR industry, using both the Economic Census data and the relevant procurement data.

As explained in the proposed rule, the major source of confusion and misunderstanding with all "exception" size standards, including the 150-

employee ITVAR size standard, is that FPDS-NG (<https://www.fpds.gov/>) does not allow contracting offers to enter the specific size standard under which the awardee was “small.” The only designation they can enter is whether the awardee was “SMALL” or “OTHER THAN SMALL.” For example, if a contract under NAICS 541519 was awarded to a “small” business, the FPDS-NG data do not show whether the awardee qualified as “small” under the regular receipts based size standard or under the 150-employee “exception” size standard. SBA agrees with the commenters that such confusion applies to all exceptions, not just the ITVAR exception. However, in view of the large value of contracts the agencies award each year using the ITVAR exception and the data, as discussed below, indicating the inconsistent application of the exception in procuring the mix of products and services, SBA is particularly concerned with the ITVAR exception.

Some commenters suggested creating a separate NAICS industry code for ITVAR firms with its own size standard to address this issue. However, SBA disagrees for two reasons. First, SBA does not have authority to create or modify NAICS industry definitions. Second, a relevant NAICS code already exists—NAICS 423430 (Computer and Computer Peripheral Equipment and Software Merchant Wholesalers). The NAICS classifies establishments based on their primary activity. ITVAR firms may provide some value added IT services; however, since selling and distributing computer hardware and software is their primary activity, they are still classified under NAICS 423430. The SBA’s 2003 final rule also noted that ITVAR firms are basically Computer and Computer Peripheral Equipment and Software Merchant Wholesalers. More importantly, many commenters also asserted that most of their revenues come from the sales of computer hardware and software. Under SBA’s rules, agencies do not use wholesale or retail NAICS codes for small business set-aside supply contracts. Agencies use the manufacturing NAICS code that describes the product to be acquired, and firms may qualify under the manufacturing size standard or the 500-employee nonmanufacturer size standard.

Confusion also exists with respect to prime contractor performance requirements or “limitations on subcontracting” (see 13 CFR 125.6 and FAR 52.219-14). Since ITVAR contracts contain both services and supply (computer hardware) components, it is

unclear whether the services or supply requirements of the limitation on subcontracting should apply to these contracts and whether the prime contractors are meeting those requirements. Similarly, confusion also exists both among contracting officers and industry participants with respect to the application of the NMR for the supply component of the contract. For the same reason, it is also difficult to ascertain if resellers provided the supplies produced by small domestic manufacturers, large OEMs, or other large manufacturers. If the resellers provided the supplies produced primarily by the large OEMs or other large manufacturers, without a waiver of the NMR that would be inconsistent with the intent of the Small Business Act. SBA is concerned that without the compliance with the NMR, the ITVAR exception may have allowed small IT resellers to simply serve as “pass throughs” for large OEMs and other large manufacturers. Some commenters stated that as much as 75 percent of total sales of many leading OEMs are fulfilled through their ITVAR partners.

With respect to the comment that, according to the 2003 final rule, the NMR does not apply to small business set-aside contracts classified under the ITVAR exception, SBA now determines that treating ITVAR contracts as services contracts and to exempt them from the NMR was an error in the 2002/2003 rule, which the agency is attempting to correct in the current rulemaking. Additionally, to include the ITVAR firms, which are, by NAICS definition, wholesalers and distributors of computer hardware and software, as part of a service NAICS code was also an error the proposed rule intended to correct. Finally, including ITVAR contracts, which are by definition supply contracts, as an exception under a service NAICS code was also inconsistent with SBA’s regulations and NAICS industry definitions. Many commenters also argued and provided supporting data that economic characteristics of the ITVAR firms are significantly different from those for IT services firms in NAICS 541519. This provides further support to the SBA’s determination in the proposed rule that the ITVAR exception should not be classified under NAICS 541519.

Regarding the comment that the proposed rule does not provide any data to support the reason that the ITVAR exception has created misuse, it should be noted that SBA’s regulations do not require the agencies to use the ITVAR exception and its 150-employee size standard. The data show that different agencies acquiring the same mix of IT

products and services are currently using the receipts based size standard, ITVAR exception with the 150-employee size standard, or the higher manufacturing size standards and nonmanufacturer size standard of 500 employees. SBA reviewed a sample of procurements posted on the Federal Business Opportunities (FBO) Web site at <http://www.fbo.gov> and found that procuring agencies appear to have struggled with selecting the appropriate NAICS code, or a size standard for set-aside procurements involving the mix of computer hardware and software and services. For example, solicitations that seemed to be for equipment, software and maintenance used the receipts based size standard, while those that appeared to be primarily for maintenance services applied the 150-employee size standard. Similarly, some solicitations that seemed to be primarily for supplies and some services used the receipt based size standard instead of the employee based size standard. In some cases, both the receipt based and the 150-employee based size standards were included. If a contract is primarily a supply contract, along with some services, that would qualify for the ITVAR exception, contracting officers can still use the higher manufacturing size standards (such as 1,000 employees for NAICS 334111, Electronic Computer Manufacturing) or the 500-employee nonmanufacturer size standard. SBA found several small business solicitations involving integration of IT hardware, software and services, but the contracting officer used NAICS 334112, Computer Storage Device Manufacturing, with a size standard of 1,000 employees, instead of the ITVAR exception with 150-employee size standard.

Some commenters believed that SBA used the lack of data as a reason to eliminate the exception, but, as explained in the proposed rule and elsewhere in the final rule, the lack of data was not the primary reason to eliminate the ITVAR exception. What SBA indicated in the proposed rule was that eliminating the exception would also address the challenge the Agency faces, due to the lack of data, when evaluating the exception size standard in the same manner the Agency evaluates the size standards for regular industries using the industry data from the Economic Census. For the reasons provided elsewhere in this rule, SBA does not agree with the commenters’ suggestions for creating a new NAICS code for ITVAR firms or reproducing the analysis from the Agency’s 2002/2003 rulemaking to address the concern for

the lack of data on the ITVAR exception. First, SBA does not see the need for creating a new NAICS code for ITVAR firms, because such a NAICS code already exists in NAICS 423430. Second, the analysis SBA provided in its 2002/2003 rules has several flaws. In accordance with its current size standards methodology, SBA has presented an alternative approach to analyzing the ITVAR industry and determining its size standard.

SBA is also concerned that by allowing contracting officers to combine services contracts with supply contracts, the ITVAR exception might be hurting small businesses that are primarily involved in IT services and are below the \$27.5 million receipts based size standard. The commenters who supported the SBA's proposal also shared these concerns. As discussed elsewhere in this rule, after the exception, the share of supply dominated contracts in total dollars awarded under small business contracts in NAICS 541519 increased sharply at the expense of the share of purely services oriented contracts.

SBA also determines that some of the other reasons the Agency provided to create the ITVAR sub-industry category in its 2002/2003 rulemaking are not unique to the procurement of IT products. For example, the SBA's reason that IT acquisitions entail numerous products, making it unrealistic to expect one manufacturer to produce all products and that the agencies prefer to fulfill their requirements from a single source, also hold true for many other acquisitions that entail numerous items involving several manufacturers. They are still subject to the manufacturing performance requirements and the NMR.

#### *Comments That There Has Been No Change in Federal IT Market or ITVAR Industry*

Many commenters argued there has been no material change in the ITVAR industry, market conditions, or how the Federal government procures IT requirements since the 2003 final rule. Therefore a change to the ITVAR size standard is not warranted, they argued. The commenters argued that SBA's reasons to create the ITVAR sub-industry category are still valid—agencies' preference to procure IT equipment and supporting services from a single source; most IT acquisitions involve numerous IT products making it unrealistic to expect for a single manufacturer to fulfill all requirements; IT contracts require services involving customization of hardware and software; and a substantial portion of

revenue of ITVARs comes from the sale of computer hardware and software.

One commenter noted that in creating the ITVAR exception, SBA identified ITVARs as a distinct industry from both IT product distributors and IT service providers. The key differentiator was the delivery of IT solutions involving both IT products and services, the commenter added. The commenter argued that significant changes in the IT landscape, especially the cloud, have validated the existence of ITVAR industry. The commenter claimed that cloud cannot be effectively delivered by a small business under a product based NAICS. Delivering cloud to the government is a perfect example of an ITVAR solution and the transition from a customer's current environment to the cloud requires significant services, the commenter added. ITVARs leverage the capabilities of a cloud provider with the addition of their own services to support delivery of a solution. The commenter argued that by treating an ITVAR contract as a service contract versus a product contract tied to the NMR makes small business participation in migration to cloud possible.

#### *SBA's Response*

SBA believes that many of the reasons the Agency provided in the 2003 final rule for creating the exception and the 150-employee size standard would remain intact when the ITVAR contracts are reclassified under the manufacturing NAICS codes. For example, using the 500-employee nonmanufacturer size standard, the agencies could still fulfill their needs for multiple products and services from a single source. Additionally, how ITVAR firms derive their revenues would not be an issue under the 500-employee based size standard. However, for the reasons discussed below, SBA disagrees with the commenters' argument that there has been no material change in Federal IT procurement and the ITVAR industry.

Prior to the exception, agencies procured computer hardware and software with some services as supply contracts under the manufacturing NAICS codes as long as the supplies remained the largest component of the total contract value. The agencies were required to comply with the NMR rule if the contracts were set aside for small businesses. For procurements that were primarily for IT services, the agencies applied one of the computer services related industry codes under NAICS Industry Group 5415. The 2003 final rule has resulted in significant changes in Federal IT procurement by allowing

the agencies to procure computer hardware and software with services using the ITVAR exception under NAICS 541519. Moreover, the small business ITVAR contracts, although by definition they are predominantly supply contracts, are not subject to the NMR, thereby allowing small ITVARs to provide products from the large manufacturers, including foreign manufacturers.

In the 2003 final rule, to arrive at the Federal procurement factor to determine the ITVAR size standard, SBA used Product and Service Code (PSC) Category D "Information Technology and Telecommunications" (PSC codes D301 through D399) to identify the "ITVAR type" contracts (*i.e.*, those involving the mix of computer hardware and software and services). During fiscal years 2001–2003, such PSCs accounted for more than 81 percent of total dollars awarded under small business set-aside contracts in NAICS 541519 and about 70 percent for other industries in NAICS Industry Group 5415. That figure for fiscal years 2012–2014 decreased to 40 percent for NAICS 541519 and to 64 percent for other industries in NAICS Industry Group 5415. Much of this decrease in NAICS 541519 could be explained by the increased share of predominantly product oriented PSCs, including ADP Software (PSC 7030), ADP Support Equipment (PSC 7035) ADP Components (PSC 7050), ADP System Configuration (PSC 7010), and ADP Input/Output and Storage Devices (PSC 7025) that the agencies procure using the ITVAR exception. For example, of total small business set-aside dollars awarded in NAICS 541519, the share of contracts classified under PSC Group 70 (Automatic Data Processing Equipment, Software, Supplies and Support Equipment) increased from less than 3 percent during fiscal years 2001–2003 to 41 percent during fiscal years 2012–2014. That percentage decreased from about 9 percent to 3 percent for other industries in NAICS Industry Group 5415. During the same period, the average value of dollars obligated under the small business set-aside contracts classified under PSC Group 70 increased from less than \$300,000 to nearly \$2.8 million for NAICS 541519 and remained stagnant at around \$500,000–\$600,000 for other industries in NAICS Industry Group 5415. SBA believes that most of these changes in Federal IT procurement under NAICS 541519 are attributable to the ITVAR exception.

Despite the above facts, SBA's proposal to eliminate the exception from NAICS 541519 was not because it believed there have been changes to the

ITVAR industry, or in the Federal IT market. Nor was it based on an assumption that the ITVAR industry is no longer relevant. Rather, the proposal was to address the inconsistency, confusion, and misuse concerning the exception.

With respect to the argument from one commenter that because of “cloud” services the ITVAR exception is more relevant today, SBA’s regulations would require the agencies to classify such contracts under one of the IT services NAICS codes with the \$27.5 million receipts based size standard. Using the 150-employee size standard and allowing companies that typically have receipts in the range of \$50 million to \$200 million to qualify for a contract whose primary purpose is services would negatively impact small businesses at the \$27.5 million receipts based size standard.

#### *Comments That SBA Should Not Implement the Proposed Rule*

Several commenters argued that the proposed rule should not be implemented because it represents a policy error from a judgmental, economic, and common sense standpoint. The commenters noted that with the absence of applicable, complete and relevant or current data regarding the impact of the proposal, the passage of the proposed rule would be arbitrary and capricious and constitute the abuse of the SBA’s rule making authority. The commenters recommended that, to move forward with the proposal, SBA should conduct a thorough and detailed analysis of the procurement and industry data, evaluate alternatives to eliminate the confusion, and misuse, and publish the analysis for further industry comment. Specifically, they suggested that SBA analyze the current data on multiple award IDIQ contracts being used to procure combinations of computer hardware and software and services from the FPDS–NG and USASpending to more accurately estimate the number of businesses that would be impacted if the proposed rule is adopted. Some commenters added that without an adequate justification and analysis, SBA’s proposed rule would harm small ITVARs and impede the ability of Federal agencies to fulfill their needs. Some commenters recommended that SBA should delay the proposed rule until it analyzes more current economic census data for a more accurate assessment of the impacts the rule would have on small ITVARs. One commenter suggested that since the ITVAR issue is related to the NMR, SBA should hold the rule until the

forthcoming proposed rule clarifying changes to NMR rule are finalized. ITVARs should be given a chance to consider the impact of the proposed change in conjunction with any proposed changes or clarifications to the NMR.

#### *SBA’s Response*

In response to the comments, elsewhere in the final rule, SBA has provided a detailed analysis of the available industry and Federal procurement data that are relevant to ITVAR firms. Similarly, SBA has also provided a detailed discussion on its position to and analyses of various alternatives that the commenters provided to eliminate the confusion, and misuse of the ITVAR exception. SBA does not agree with the suggestion to delay the proposed rule until SBA analyzes more current Economic Census data, which will not be available until late 2016.

SBA acknowledges that, if adopted, the proposed rule would have some impacts on businesses that currently perform ITVAR contracts under the 150-employee ITVAR size standard. Further, agencies would benefit by having a bigger pool of firms to compete for IT product contracts. The businesses that are currently small under the ITVAR size standard would continue to qualify as small, except for that they would need to compete with somewhat larger businesses between 150 employees and 500 employees and comply with the NMR. Without the exception, the agencies would reclassify IT supply contracts under the applicable manufacturing NAICS codes and be able to fulfill their requirements through a single reseller or distributor under the 500-employee nonmanufacturer size standard, except for that they would be required to comply with the NMR. This is how the agencies were procuring IT products prior to the exception. Based on the procurement data analyzed and discussed in this rule, SBA does not believe that the impacts from these changes would be as detrimental as projected by the commenters.

#### *Comments on the Inapplicability of Manufacturing NAICS Codes and the NMR*

Several commenters rejected SBA’s statement that, under the proposed rule, agencies would reclassify computer hardware and software supply contracts under the manufacturing NAICS codes and ITVARs below 150 employees could qualify under the 500-employee nonmanufacturer size standard. They argued that it would not only be unfair to compel ITVARs with less than 150

employees to compete with large companies (including OEMs) with 500 employees to 1,500 employees, but it would also create significant problems for agencies to obtain the best combination of IT services, equipment and software in a timely manner. Some noted that SBA’s assessment in the proposed rule that ITVAR contracts could easily transition to product based NAICS codes without significant harm to small businesses is incorrect. Others argued that using the manufacturing NAICS codes, instead of the ITVAR exception, would create an undue burden on small ITVARs by forcing them to compete in various manufacturing NAICS codes dominated by much larger companies.

The commenters expressed various concerns about classifying IT supply contracts under the manufacturing NAICS codes with a higher employee size standard or 500-employee nonmanufacturer size standard, instead of the 150-employee ITVAR size standard. One commenter argued that the existence of an alternative purchasing method does not justify the removal of a well-established NAICS exception. Some commenters stated that manufacturing NAICS codes are not designed to supply IT products and do not include value added services that ITVARs offer with the products. Others claimed that classifying IT supply contracts under the manufacturing NAICS codes would create a significant workload for SBA in responding to requests for waivers of the NMR and would substantially delay IT procurements.

Many commenters expressed concerns against classifying IT supply contracts under the manufacturing NAICS codes because of the NMR. They argued that resorting to a manufacturing NAICS code would force small ITVARs to a restrictive nonmanufacturer size standard unless there is a waiver from the NMR. The commenters contended that the waiver process is cumbersome and in some cases waivers are difficult to obtain in a timely manner. They further argued that the NMR would significantly limit the number of products a small business could offer to the government. This would, as the commenters added, not only restrict the small ITVARs from providing the full spectrum of desired products to agencies, but would also restrict the government’s ability to procure the state-of-the-art technology products through small businesses. Some commenters argued that, from a practical standpoint, the ITVAR contracts would be unlikely to be set aside for small businesses because there

are not many small businesses that manufacture hardware and equipment to meet the demand. The commenters argued that if the exception is eliminated and contracts to procure computer hardware and software are reclassified under the manufacturing NAICS codes, many businesses considered small under the exception would not be able to participate because it would not be possible to comply with the NMR for every item that can be currently sold under the ITVAR exception.

One commenter noted that, by using the 150-employee ITVAR size standard, agencies are currently able to procure multiple IT products and services through a single procurement without the requirement to supply products manufactured by small business concerns or having to secure SBA's waivers for numerous products on the procurement. As the commenter continued, the ITVAR exception also allows small resellers to offer the most optimum combination of products from both small and large manufacturers, thereby providing the best value to the government, which would not be possible if they are compelled to offer the products from small manufacturers under the NMR. The commenter concluded that this can become very complex when there are similar products manufactured by small manufacturers that are not compatible with other IT equipment or software that must be used in combination to best meet agency requirements.

One commenter noted that if agencies are compelled to use the manufacturing NAICS codes to obtain both IT services and products, they would run the risk of the NMR delaying the procurement or preclude the utilization of the most optimum combination of IT products to meet their requirements. The need to justify and obtain waivers from the NMR, the commenter claimed, would discourage agencies from setting aside IT procurements for small businesses under the manufacturing NAICS codes. Thus, the commenter concluded, the elimination of the ITVAR exception and its 150-employee size standard could significantly reduce the number and magnitude of ITVAR contracts set aside for small businesses. Another commenter contended that using the 500-employee nonmanufacturer size standard would put small ITVARs (with 50–60 employees) in direct competition with larger companies with up to 500 employees. The commenter added that unless a company is allowed to separate hardware and software revenue from services for the purpose of being small under NAICS Industry Group 5415, very

few value added resellers would remain small.

One commenter supporting SBA's proposal argued that it would be impossible to comply with the NMR for acquisitions of IT products (e.g., software and hardware) even if they are properly classified under a manufacturing NAICS code, because many of the IT products desired by the government are not manufactured by small businesses and do not have waivers. As such, these procurements are fundamentally defective because no small businesses could perform the requirements of the contract without violating SBA's regulations. The commenter suggested that acquisitions for IT products should be competed on a full and open basis.

#### *SBA's Response*

If the ITVAR exception is eliminated as proposed and ITVAR contracts are reclassified under the manufacturing NAICS codes, the size standard for an IT reseller would be only 500 employees, although the size standard for computer and peripheral equipment manufacturing related NAICS codes is higher at 1,000 employees. While SBA acknowledges that these businesses would have to compete with businesses between 150 employees and 500 employees, it disagrees with the commenters' argument that eliminating the ITVAR exception would force them to compete with large companies up to 1,500 employees.

SBA did not propose to eliminate the ITVAR exception simply because there is an alternative method to procure IT supplies using the 500-employee nonmanufacturer size standard. The proposal was to ensure that small business IT supply contracts, like all other supply contracts, are in compliance with applicable statute and regulations, especially the NMR and limitations on subcontracting. The Small Business Act provides that, on a supply contract set aside for small business, the offeror must account for 50 percent of the cost of manufacturing the product, or qualify as a nonmanufacturer. Under the Small Business Act and implementing regulations, a firm may qualify as a nonmanufacturer on a supply contract set aside for small business by supplying the product of a small business or SBA must have issued a class or individual contract waiver of the NMR, which would allow the nonmanufacturer to supply the product on any size business. Additionally, the rule proposed to eliminate the ITVAR sub-industry only as an exception to

NAICS 541519, but not the ITVAR activity altogether.

SBA does not agree with the comment that the manufacturing NAICS codes are not designed to supply IT products and do not include value added services that ITVARs offer with the products. The regulation allows agencies to include some services in IT supply contracts classified under the manufacturing NAICS codes as long as the products remained the principal purpose of the contract. Prior to the ITVAR exception, agencies were using the manufacturing NAICS codes to procure IT products that required some services. Even now with the exception, many agencies procure the mix of IT products and services using the manufacturing NAICS codes. As stated elsewhere, even with the ITVAR exception, agencies use the manufacturing NAICS codes to obtain computer hardware and software through various GWACs, including NIH's ECS-3 and Army's ITES-2H.

SBA does not believe that the waiver process of the NMR is cumbersome and that waivers are difficult to obtain in a timely manner are good reasons for not applying the statutory rule. SBA believes it is inconsistent and unlawful to require distributors or resellers of thousands of other products to comply with the NMR and exempt the resellers of IT products from the rule. While SBA recognizes that the NMR may work better for some products than for others, it strongly believes that the rule must apply to all supply contracts equally. Thus, similar to all other products and supplies, the NMR must also apply to IT products, including those purchased through the ITVAR exception. SBA is aware and agrees with some commenters that small business manufacturers may not be available to comply with the NMR for the procurement of some computer hardware and software. Under those instances, the regulations allow agencies to request waivers of the NMR from SBA, as they have done for hundreds of other products. In fact, waivers already exist for a wide range of IT products under computer and peripheral equipment manufacturing related NAICS codes (see <https://www.sba.gov/content/class-waivers>). However, based on SAM and FPDS-NG data, SBA believes that there are small manufacturers for a wide variety of IT products, which may have been deprived from Federal opportunities under the ITVAR exception because of the inapplicability of the NMR to procurements under the ITVAR exception.

Reclassifying ITVAR contracts under the manufacturing NAICS codes would

not change the agencies' ability to procure multiple IT products from a single source. They could continue to acquire multiple products from a single source by using the 500-employee nonmanufacturer size standard. Similarly, this would also not affect resellers' ability to provide the most optimum combination of IT products from multiple manufacturers. If the products from small manufacturers are not compatible with other hardware and software, agencies may request a waiver of the NMR for the items.

While ITVAR contracts include some services, they are basically supply contracts. Thus, according to the SBA's regulations, like all other supply contracts, ITVAR contracts should be classified under the applicable manufacturing NAICS codes. If such contracts are set aside for small businesses, they are also subject to the NMR. If there are no domestic small manufacturers of the products being procured to comply with the NMR, agencies can request waivers. The potential burden on agencies to obtain NMR waivers is not a convincing reason for not following the statute, because compliance with the NMR and obtaining waivers is ultimately in the interest of small businesses. Similarly, the arguments that it would create a significant workload for SBA to respond to requests for nonmanufacturer waivers and substantially delay IT procurements are not good reasons for not complying with the statute. SBA believes that potential delays, if any, resulting from the requests for waivers can be ameliorated by proper planning and scheduling of contracts. Even if agencies are currently setting aside many IT contracts for small businesses using the exception, without the NMR, most of the benefits of those contracts are simply passed through to large OEMs or other large manufacturers, including foreign companies. Many commenters themselves stated that small resellers have only small profit margins on ITVAR contracts. SBA disagrees with the suggestion to separate revenues from computer hardware and software sales from services to allow ITVARs to qualify as small under the receipts based size standard. First, for size standards purposes, SBA defines the size of a business concern in terms of its overall revenues or employees, not in terms of revenues or employees for specific products or services. Second, allowing ITVAR firms with revenues significantly higher than the receipts based size standard to qualify as small would negatively impact businesses below the receipts based size standard.

Finally, with respect to the comment that IT products should only be competed on a full and open basis, SBA believes that doing so would not only hurt many existing small businesses by forcing them to compete with the largest firms, which dominate the industry, it would also reduce competition and innovation in the economy.

#### *Comments That the Proposed Rule Violates Statutory Requirements*

One commenter applauded SBA for complying with the Jobs Act, but noted that the proposed rule violates the statutory language added to the Small Business Act by the National Defense Authorization Act for Fiscal Year 2013 (NDAA 2013). The commenter added that the provisions in the proposed rule concerning the ITVAR size standard fail to address the issues facing the IT industry and the misuse of the size standards.

The commenter noted that modifications to SBA's size standards have significant implications for SBA programs, Federal procurement opportunities for small businesses, the Regulatory Flexibility Act, Executive Order 12866, and Federal regulatory programs in which the term "small business" is used. For these reasons, the commenter urged SBA to withdraw the current proposed rule and directed it to undertake a rulemaking that is legally sufficient, withstands judicial scrutiny, and does not tempt Congress to take ameliorative action.

The commenter was concerned with limiting the number of size standards to choose from and applying common size standards for some industries. The commenter referred to the SBA's 2011 proposed rule on NAICS Sector 54 where the Agency had proposed the common size standards for industries in NAICS Industry Group 5413 (Architectural, Engineering, and Related Services) and Industry Group 5415 (Computer Systems Design and Related Services).

The commenter claimed that the proposed rule violated the statutory provisions of the NDAA 2013 relating to SBA's size standards. Specifically, the commenter noted that the proposed rule does not follow the statutory provisions of the proposed rulemaking, does not honor the statutory prohibition on common size standards, and ignores the statutory language on the number of size standards. The commenter considered that the proposed rule is fundamentally flawed because SBA applied the same methodology prior to NDAA 2013 without any change to increase the size standards for 30 industries and three sub-industries, and to eliminate the

ITVAR sub-industry or exception to NAICS 541519.

With respect to the statutory provisions of the rulemaking, the commenter noted that for the majority of the 30 industries that face a changed size standard, the only description provided is the NAICS code and industry title. The commenter argued that the proposed rule did not provide the types of analyses SBA provided in its 2003 final rule to establish the ITVAR exception and the 150-employee size standard.

The commenter argued that with no justification for the use of the "anchor size standard" approach as a basis for evaluating characteristics of individual industries, the proposed rule violates the statutory requirement on using common size standards. The commenter also challenged the proposed rule for placing the ITVAR firms under one of the common size standards created in 2012 that, as the commenter contended, prompted Congress to change the statute.

The commenter noted that by limiting the number of employee based size standards to five levels (500 employees, 750 employees, 1,000 employees, 1,250 employees, and 1,500 employees), SBA disregarded the statute in the proposed rule. In response to SBA's approach against the practicality and need for establishing separate size standards for each of 1,000 plus industries, the commenter indicated that Congress would not oppose thousands of size standards as they would provide better insights into the small business industrial base, inform the creation of better scope of work for contracts, increase opportunities for small businesses, and mitigate the impact of outgrowing the size standard.

Another commenter argued that proposed rule does not comply with the RFA. The commenter noted that the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA), requires the agency to consider the impact of the proposed rulemaking on small entities and analyze alternatives to minimize the impacts on small entities. The commenter argued that the SBA's IRFA does not include any discussion on the impact of eliminating Footnote 18.

#### *SBA's Response*

With respect to the impact of the NDAA 2013 on the comprehensive review required by the Jobs Act, SBA maintains its existing approach is consistent with those requirements. SBA's methodology, as outlined in its publicly available white paper and utilized in each proposed and final

rulemaking, discusses the impact on firms, provides an analysis of the competitive environment, discusses the sources of data, and the anticipated effect on firms. If SBA proposes common size standards, it will and does provide a justification in the proposed and final rule. Further, SBA is not limiting the number of size standards. It is important to note that much of the data available is based on ranges. It is not possible to establish size standards at such a granular level that size standards would vary by a single dollar or single employee. When conducting economic analysis using varying data sources and multiple factors, there must be some rounding to dollar values or employee numbers. However, for the review of employee based size standards, to the extent permitted by the 2007 Economic Census tabulation and other available data, SBA adjusted its size standards methodology in response to the NDAA 2013 requirements. Specifically, for manufacturing and other industries that have employee based size standards for which SBA published the proposed rules on September 10, 2014, the Agency added an additional size standard level of 1,250 employees between 1,000 employees and 1,500 employees. In addition, SBA increased the number of size standards for industries in Wholesale Trade for SBA's financial assistance. Currently, all industries in Wholesale Trade have one common size standard of 100 employees for SBA's loans. SBA had proposed three additional size levels, namely 150 employees, 200 employees and 250 employees and published the rule for comments (79 FR 28631 (May 19, 2014)). SBA proposed no common size standards for any industries that have employee based size standards. As part of preparation for the next round of the size standards review as required by the Jobs Act, SBA is currently reviewing and updating its current "Size Standards Methodology" White Paper to incorporate the provisions of the NDAA 2013 to the extent possible. SBA plans to issue the updated methodology for public comments and finalize it prior to launching the next round of size standards review, possibly in the first quarter of Fiscal Year 2017.

SBA disagrees with the comment that the proposed rule did not provide any analysis of industry data or the competitive environment to the industries that faced a size standard change. As explained in the proposed rule and the methodology white paper, when developing the proposed rule, SBA examined several factors (such as

average firm size, measures of start-up costs and barriers, industry concentration, and distribution of firms by size) to evaluate the competitive environment in specific industries, not just the NAICS industry code and title. In addition, SBA also evaluated the Federal contract market place in terms of ability of small businesses to compete for Federal opportunities under the existing and changed size standards. As part of the regulatory impact analysis as required by Executive Order 12866 and the IRFA as required by the RFA, SBA provided the impacts of the proposed rule, including the number of businesses impacted and their participation in Federal contracting and SBA's financial assistance.

As discussed elsewhere in this rule, based on the review of the 2003 final rule, SBA has determined that the analysis the Agency used to create the exception had several flaws. In response, in this final rule, SBA has provided alternative approaches to analyzing the ITVAR activity that are more consistent with the SBA's current size standards methodology and NAICS industry definitions.

Since SBA did not receive major adverse comments against using the common size standard for industries under NAICS Industry Group 5415 (Computer Systems Design and Related Services), SBA retained the common size standard for those industries in the final rule. Moreover, adopting industry specific size standards would have meant lowering size standards for some industries in that group. It is not the current proposed rule that placed the ITVAR firms under NAICS 541519 that share a common size standard with three other computer services related industries (*i.e.*, 541511, 541512, and 541513). Rather, SBA decided to place the ITVAR exception under NAICS 541519 in its 2002–2003 rulemaking that created the ITVAR exception. It should be noted that SBA created the common size standard for "Computer Programming, Data Processing and Other Computer Related Services" in the early 1990s (56 FR 38364 (August 13, 1991) and 57 FR 27907 (June 23, 1992)), not in the 2012 final rule for NAICS Sector 54.

With respect to the anchor size standard, it should be noted that SBA provides a detailed justification for using the "anchor size standard" approach in its "Size Standards Methodology" White Paper, as cited in the proposed rule. In fact, SBA has been using the "anchor" approach since the 1980s when reviewing and modifying size standards without much concern from the public. As part of its effort to

address new statutory requirements and improve the methodology, SBA is considering alternative approaches to evaluating industry characteristics in the next round of the review.

Regarding the comment on limiting the number of size standards, there have been concerns from businesses and the contracting community that size standards are too complex to understand and cumbersome to use. To simplify, SBA proposed to reduce the number of receipts based size standards to eight (8) from 31 different levels that existed at the start of the current size standards review. However, because of Agency general policy to not lower size standards except to exclude the dominant firms, there are still 17 different receipts based size standards in effect. In all proposed rules on receipts based size standards, SBA sought comments on the number of size standards available to apply for individual industries. Almost all comments addressing this issue strongly supported the SBA's proposed eight receipts based size standards. Since its publication for comments in 2009, SBA had received many comments specific to its size standards methodology and almost all of those comments supported using a fixed number of size standards. Moreover, SBA has received no concerns from the public and contracting communities that limiting the number of size standards is having an adverse impact on small businesses or contracting activities. Additionally, in the proposed rule, SBA did not reduce the number of employee based size standards. Rather, as mentioned elsewhere in the rule, SBA expanded the number of employee based size standards by adding an additional size standard level of 1,250 employees between 1,000 employees and 1,500 employees. Furthermore, in this rule, SBA has lowered size standards for three industries from 500 employees to 250 employees to prevent the largest and dominant firms from being qualified as small. Until this rule, for purposes of Federal procurement, no industry had an employee based size standard lower than 500 employees. As stated earlier, SBA is currently reviewing and updating its current "Size Standards Methodology" White Paper (methodology) to incorporate the provisions of the NDAA 2013 to the extent possible.

SBA does not agree with the comment that the proposed rule did not provide the impact analysis of the proposed elimination of the ITVAR exception. As part of regulatory impact analysis as required by Executive Order 12866 and IRFA as required by RFA, SBA provided

the estimate for the number of small businesses impacted by changes to industry size standards covered by the proposed rule, along with estimates on the impacts on small business participation in Federal procurement and SBA financial assistance programs. As in all previous proposed and final rules on size standards for other NAICS sectors, SBA only provided the aggregate estimates of the impacts for all affected industries, instead of separate estimates for each industry or sub-industry.

*Comments That the Proposed Rule Violates Congress' Intent on the Jobs Act*

Five commenters contended that by eliminating the ITVAR exception and its higher 150-employee size standard and replacing it with the lower \$27.5 million receipts based size standard, the proposed rule violates Congress' intent in the Jobs Act to increase size standards. To support this contention, one of the commenters referred to Section 404 of the Report from the Committee on Small Business and Entrepreneurship where the Committee discussed Federal market conditions and the need for a reasonable increase in size standards (S. Rep. 343, 111th Cong., 2d Sess. (Sep. 29, 2010)).

*SBA's Response*

SBA disagrees for two reasons. First, with the proposed elimination of the ITVAR exception, ITVAR contracts, which by definition are primarily supply contracts, would be reclassified under applicable manufacturing NAICS codes for which all current small ITVARs would continue to qualify as small under the 500-employee nonmanufacturer size standard. As a result, ITVARs would actually see an increase in their size standard, not a decrease. Second, the Jobs Act required SBA to conduct a detailed review of size standards and make appropriate adjustments to reflect market conditions. SBA believes such adjustments would mean either increases or decreases to size standards, not only increases. Thus, even if the elimination had resulted in a decrease to the size standard, SBA does not believe that would constitute a violation of the Jobs Act.

*Comments That the Proposed Rule Conflicts With Retention of Other Exceptions*

A couple of commenters argued that SBA's reason to eliminate the ITVAR exception for lack of data in the Economic Census is inconsistent with its decisions to retain all other exceptions in other industries. Another

commenter was concerned that the same reason may lead SBA to eliminate other size standards exceptions that were put in place for important reasons, which will negatively impacts those industries and Federal customers.

*SBA's Response*

As stated elsewhere in this final rule, lack of data was not SBA's primary reason for eliminating the ITVAR exception. SBA's primary reason for the proposal was to eliminate the inconsistency, confusion, and misuse that the exception has created. Only as an ancillary reason, SBA noted that the proposal would also ameliorate the challenge SBA faces when evaluating economic characteristics and size standards for exception categories. The challenge is especially acute here because the industry represented by Footnote 18 is already represented in the NAICS table under the wholesale NAICS code. In other words, the data challenge exists because SBA created an exception for suppliers under a services NAICS code.

As part of its comprehensive review of all size standards, SBA has considered whether each of the existing exceptions or footnotes to size standards could be eliminated. As a result, SBA eliminated Footnote 1 relating to the size standard for electric utilities (see 78 FR 77343 (December 23, 2013), the Map Drafting exception to NAICS 541340 (Drafting Services) (see 77 FR 7490 (February 10, 2012)), and Aircraft Dealers, Retail exception to NAICS 441229 (All Other Motor Vehicles Dealers) (see 75 FR 61597 (October 6, 2010)). More recently, in the same proposed rule, partly for the lack of data, SBA also proposed eliminating the Offshore Marine Air Transportation Services exception to NAICS 481211 (Nonscheduled Chartered Passenger Air Transportation) and NAICS 481212 (Nonscheduled Chartered Freight Air Transportation and Offshore Marine Services exception (along with Footnote 15) to NAICS Subsector 483 (Water Transportation).

Additionally, although SBA, after public comments, has decided to retain some of the exceptions in the final rules, the Agency had always discussed in the proposed rules the data issues related to evaluating all exception categories and associated size standards and sought comments if they could be removed. For these reasons, SBA does not agree with the commenter that the proposal to eliminate the ITVAR is totally inconsistent with its decision to retain other exceptions. In addition, SBA did not remove other exceptions mainly because doing so would have forced

many small businesses to lose their small business status as in most cases exceptions have higher size standards than those for regular industries. That is not the case with removing the ITVAR exception because, as stated elsewhere in the rule, if the ITVAR exception is eliminated, the ITVAR contracts would be reclassified under applicable manufacturing NAICS codes and all ITVARs below 150 employees would continue to qualify as small for those contracts as small businesses under the 500-employee nonmanufacturer size standard.

*Comments Suggesting Alternatives to SBA's Proposal*

In response to SBA's rationale to remove the ITVAR exception because it has created inconsistencies, confusion, and misuse, many commenters suggested alternative measures or courses of action to address these issues rather than eliminating the exception. These include modifying FPDS-NG to enable contracting officers to identify or show the exception size standard, creating a new NAICS code for the ITVAR exception with its own size standard, requiring ITVAR contracts and task orders to indicate separate values for goods and services, and development of training and guidelines for procurement officials to ensure the proper application of the size standard exception.

With respect to the new ITVAR NAICS code, the commenters suggested that SBA should develop a new or independent NAICS industry code to represent the ITVAR activity, as defined in Footnote 18, with an employee based size standard of 150 employees, while keeping NAICS 541519 intact with its current \$27.5 million receipts based size standard. The commenters further recommended that SBA should analyze the data on both the multiple award IDIQ contracts used to acquire the mix of IT products (hardware/software) and services under NAICS 541519 and small businesses that are selected to perform these acquisitions to support the creation of the new ITVAR NAICS code. One commenter also suggested making the new ITVAR NAICS code a service NAICS code, with a 150 employee size standard. As an alternative to creating a new ITVAR NAICS code, one commenter suggested creating a new IT services NAICS code with a size standard of 150 employees.

In response to SBA's reason to remove the exception due to the lack of data to evaluate the ITVAR industry, one commenter suggested refining the Economic Census to collect data on ITVARs, while another suggested

creating a product service code (PSC) for ITVAR contracts to track data on ITVARs in FPDS-NG. Another suggested that SBA should reproduce the type of the analysis it did in the 2002-2003 rulemaking by combining the data for Computer Systems Design and Related Services (NAICS Industry Group 5415) and for the Computer and Computer Peripheral Equipment and Software Merchant Wholesalers industry (NAICS 423430) from the Economic Census and data from the industry, such as Computer Reseller News. In addition, the commenter suggested GSA's Federal Supply Schedules for IT solutions and SAM as additional sources of data to analyze ITVAR firms. A number of commenters recommended that SBA should review the procurement data from FPDS-NG and USASpending.

Some commenters argued that, rather than eliminating the 150-employee size standard, the confusion from having two size standards in NAICS 541519 could best be cured by eliminating the \$27.5 million receipts size standard and adopting the 150-employee size standard as the single size standard for entire NAICS 541519. On a different note, instead of removing the exception and its 150-employee size standard, one commenter suggested lowering its size standard to 50, 75, or 100 employees, without a dollar limit.

Another commenter argued that, if SBA eliminates the ITVAR exception, only the services provided by the small firms should be counted in the calculation of annual receipts and hardware and software obtained from other suppliers or manufacturers should be excluded. The commenter further argued that this is similar to excluding the amounts collected for a third party from the receipts by travel agents, real estate agents, advertising agents, conference organizers and freight forwarders.

#### *SBA's Response*

As explained elsewhere in the rule, SBA does not agree that there is the need to create a new NAICS code for ITVARs, because such a code already exists in NAICS 423430. The Economic Census data show that more than 80 percent of revenues of firms in NAICS 423430 come from the sales of computer hardware and software. Many commenters also affirmed this by saying that ITVARs' revenue merely reflects the sales of computer hardware and software. The SBA's 2003 final rule also stated that ITVARs are part of NAICS 423430. Additionally, SBA has no authority or expertise to create or modify NAICS industry codes or

definitions. Creating or modifying NAICS industry definitions or codes is done through the U.S. Economic Classification Policy Committee under the Office of Management and Budget (OMB) in cooperation with statistical agencies from the U.S., Canada, and Mexico. If the industry believes that a new NAICS code is warranted for the ITVAR industry, it should approach OMB (see <http://www.census.gov/eos/www/naics/>). Every five years, OMB updates NAICS codes and definitions, the next being the NAICS 2017 updates to be effective January 1, 2017.

SBA also disagrees with the suggestion to apply a single size standard of 150 employees for both IT services firms in NAICS 541519 and ITVARs. SBA believes that such a size standard would negatively impact small businesses at or below the \$27.5 million receipts level by forcing them to compete against some ITVARs with significantly larger receipts levels and more financial resources. Several commenters noted that ITVARs below 150 employees have a much stronger financial base and better creditworthiness as compared to their counterparts below the \$27.5 million receipts based size standard. Without ITVARs, the industry data would actually support a 150-employee size standard for NAICS 541519. However, to conform to its general policy of using number of employees to measure business size of firms in manufacturing industries and receipts to measure business size in services industries, SBA will maintain the receipts based size standard for NAICS 541519.

Several commenters suggested reproducing the analysis SBA performed in its 2003 final rule. However, SBA disagrees with the 2003 analysis for the following reasons:

1. Both the 1997 Economic Census data used in the 2003 final rule and 2007 Economic Census data (still latest available) showed vast differences between the characteristics of firms in Industry Group 5415 and those in NAICS 423430. For example, based on the 1997 data, sales of computer hardware and software accounted for 81 percent of total receipts in NAICS 423430, as compared to less than 5 percent in NAICS Industry Group 5415. The corresponding figures for the 2007 Economic Census data were about 83 percent and 9.5 percent, respectively. Many commenters also argued that firms in NAICS Industry Group 5415 have vastly different economic characteristics as compared to ITVAR firms and that the two cannot be compared. The commenters further argued that most of the receipts of

ITVAR firms come from the sales of computer hardware and software. Despite these differences, SBA combined the data from these very distinct NAICS industry categories into one and defined the result as the new ITVAR industry and included it as sub-industry or exception under NAICS 541519.

2. In combining the two industry categories, SBA only included the services segment in NAICS 423430, which accounted for only about 14 percent of total receipts in that industry. The sales of computer hardware and software segment, which is the primary activity of ITVARs and accounted for more than 80 percent of total sales in that industry, were excluded. SBA has reproduced that analysis and determined that, had the computer hardware and software segment in NAICS 423430 been included in creating the ITVAR industry, the results would have supported a substantially larger size standard than 150 employees.

3. There is no need to create a new industry for ITVAR firms. ITVARs, because they are primarily engaged in the distribution or resale of computer equipment and software, are already classified under NAICS 423430. In the 2003 final rule, SBA selected NAICS Industry Group 5415 and NAICS 423430 for constructing the ITVAR industry based on an assumption that ITVAR firms operate in either one of these categories. As reflected in the Economic Census data, some firms in NAICS Industry Group 5415 may provide some computer hardware and software, but most of their revenue comes from services. Similarly, firms in NAICS 423430 may provide some services, but the vast majority of their revenue comes from the sales of computer hardware and software.

4. As discussed exhaustively in this rule, SBA now disagrees with the decision to include the exception meant for primarily supply contracts as an exception to NAICS 541519, which is a service NAICS code. Furthermore, SBA sees no legal basis to treat ITVAR contracts as services contracts, thereby exempting them from the manufacturing performance requirements and the NMR.

SBA now believes that, in accordance with SBA's current "Size Standards Methodology," any analysis for establishing industry characteristics of ITVAR firms should focus on data for NAICS 423430, which is their primary industry. All firms in Wholesale Trade (NAICS Sector 42) share the same 500-employee size standard for purposes of Federal procurement under the NMR. If ITVAR firms need any special

provisions from the size standard or from the NMR, such provisions should be addressed within the context of the same rule. If ITVAR firms needed a separate employee based size standard, it should be based on data from NAICS Sector 42.

With respect to data sources, SBA has obtained data from SAM and FPDS-NG to evaluate industries or sub-industries (“exceptions”) that are not covered by the Economic Census. However, SBA is concerned that this data does not provide an accurate and representative picture of all firms within the industry. The data from those sources only pertain to firms that are either registered in SAM or have received Government contracts. The results from these sources generally tend to support much larger size standards than those supported by the Economic Census data. Some commenters suggested that SBA should use the private data sources that SBA used in the 2003 final rule. However, in the 2003 final rule, SBA considered private sources for data on ITVAR firms, but for several reasons as explained in that rule, it did not utilize them in establishing the characteristics of the ITVAR industry.

SBA disagrees with the suggestion for creating a new IT services NAICS code with a 150-employee size standard. First, there already exist four NAICS codes under Industry Group 5415 to include a wide range of IT related services, including those that can be included under ITVAR contracts. Second, it would hurt small businesses under the \$27.5 million receipts based size standard by forcing them to compete with businesses with much larger receipts and better financial resources. That would likely encourage contracting officers to use the 150-employee size standard for IT services contracts instead of the receipts based size standard. This would not only create more confusion, but also would have detrimental impact on small businesses that are currently receiving small business contracts under the receipts based size standard.

SBA also disagrees with the suggestion to allow ITVAR firms to exclude the revenue from computer hardware and software sales from the calculation of receipts, similar to travel agents, real estate agents, advertising agents, conference organizers and freight forwarders. In calculating receipts for size standards, SBA follows the U.S. Census Bureau’s definition of receipts for its Economic Census. Accordingly, SBA defines receipts for travel agents, real estate agents, advertising agents, conference organizers, and freight forwarders based

on their net commissions by excluding the amount they collect on behalf of the third parties. The same definition does not apply to ITVAR firms. Additionally, as explained elsewhere, by allowing the ITVAR firms to exclude sales from computer hardware and software from receipts and qualify under the receipts based size standard would hurt many IT services firms below the receipts based size standard.

Vendors of computer hardware and peripherals are not comparable to travel agents, real estate agents, advertising agents, conference organizers, and freight forwarders. Receipts from the sale of computer hardware substantially increase the size of a business. Those receipts can be used to replenish inventory, pay employees, reduce payables and debt, pay bonuses, and for other business purposes. They add to the business’ asset base and net worth. However, travel agents and similarly operating businesses operate on a commission and/or fee basis. Their receipts are held in trust. The funds do not add to the business’ asset base, and cannot be used to reduce payables or debt, or for any other business purposes. For sellers of computer hardware, the receipts constitute revenue. For travel agents and the like, although their total receipts may be high, most of their receipts do not constitute revenue.

#### *Other Comments on the ITVAR Exception*

A few commenters noted that instead of focusing its efforts on eliminating the exception and on solving the non-existent problem, SBA should focus its effort toward preventing small business contracts from being diverted to large Fortune 500 companies and their subsidiaries.

In response to SBA’s justification to change size standards because of the comments that size standards have not kept up with changes to the economy, the commenter argued that those comments are false because there have been no changes to the percentage of U.S. firms that have less than 100 employees.

One commenter also countered a comment from another commenter in support of the SBA’s proposal that the removing the ITVAR exception will help level the playing field for companies looking for Federal opportunities by stating that the exception is allowing companies making hundreds of millions of dollars to bid as small businesses on ITVAR contracts, thereby blocking true small businesses from Federal opportunities. The commenter dismissed the supporting comment as a misleading

and improper comparison between ITVARs and IT services providers for failing to account for the ITVAR’s business and operational model. The commenter stressed that although ITVARs with 150 or fewer employees have annual receipts substantially higher than \$27.5 million, they are truly small. The commenter argued that since, unlike general IT service providers, ITVARs also provide products with very thin profit margins, it would be unfair to compare them using the same revenue levels.

#### *SBA’s Response*

While SBA is committed to ensure that Federal government contracts set aside for small businesses only go to small businesses, not large businesses, the issue is beyond the scope of this rule. With respect to the comment regarding whether or not the size standards need to be adjusted, the U. S. Congress has required SBA to review all size standards and make necessary adjustments to reflect market conditions every five years (*see* Public Law 111–240, Section 1344). Although the percentage of firms below 100 employees has remained more or less constant over time, their market share in the economy has been shrinking. For example, the share of total sales/receipts of firms with less than 100 employees decreased from nearly 29 percent in 1997 to less than 26 percent in 2007 and those of larger firms has increased. The data would suggest bigger changes in many individual industries. The commenter’s rebuttal of another comment in support of SBA’s proposal also supports the Agency’s current position that ITVARs should not be treated as an exception to the receipt based size standard that applies to IT services.

#### **Comments on the Environmental Remediation Services Exception**

On September 15, 1994, SBA issued a final rule designating Environmental Remediation Services (ERS) an “exception” under Standard Industrial Classification (SIC) code 8744, Facilities Support Management Services, with a size standard of 500 employees (59 FR 47236). Effective October 1, 2000, SBA adopted NAICS replacing the SIC system for its table of size standards (65 FR 30836). Currently, the 500-employee size standard for ERS is an “exception” to the \$20.5 million receipts based size standard for NAICS code 562910, Remediation Services. The 500-employee size standard applies to Federal procurements that involve three or more services related to restoring a contaminated environment, such as

preliminary assessment, site inspection, testing, remedial investigation, remedial action, containment, and removal and storage of contaminated materials. The requirements that apply to the ERS exception and its 500-employee size standard for Federal procurement and SBA's financial assistance are in Footnote 14 to SBA's table of small business size standards (13 CFR 121.201).

In the September 10, 2014 proposed rule, SBA proposed to increase the size standard for the ERS exception under NAICS code 562910 from 500 employees to 1,250 employees. SBA sought public comments on its analyses of the industry and Federal market data and its justification for the proposal to increase the size standard for the ERS exception from 500 employees to 1,250 employees. SBA received 32 comments, 26 of which were from currently small businesses (*i.e.*, with 500 or fewer employees) and six from other than small businesses (*i.e.*, those with more than 500 employees). Commenters included women owned small businesses (WOSBs), current and former HUBZone and 8(a) businesses, service disabled veteran owned small businesses (SDVOSBs), and minority and Native American owned companies. As stated earlier, 23 commenters opposed SBA's proposal to increase the ERS size standard to 1,250 employees and nine supported it. Three of the commenters opposing the proposed 1,250-employee size standard suggested a smaller increase to 750 employees. One large business commenter supporting SBA's proposal suggested that SBA adopt a higher 1,500-employee size standard. These comments and SBA's responses are discussed below.

#### *Comments Supporting SBA's Proposal To Increase the ERS Size Standard to 1,250 Employees*

Commenters that supported the proposed increase of the ERS size standard to 1,250 employees reasoned that it would enable small businesses to grow beyond 500 employees. The commenters argued that the higher size standard would open doors to firms that have purposely remained under the 500-employee standard, and it would thereby spur business expansions and job creation. They noted that due to increased consolidation in the ERS industry there exists a large gap between firms below 500 employees and very large firms, thereby rendering smaller firms no longer able to compete for Federal opportunities on a full and open basis. The commenters argued that the higher size standard would close this gap between small and very large firms.

They contended that the current size standard does not reflect the consolidated structure and current economic reality of the ERS industry and added that the proposed higher size standard represents a more accurate reflection of current market conditions in the ERS industry. Some commenters stated that since the size standard for ERS has not changed since 1994, the proposed increase would be a reasonable step toward matching current market conditions. With a disproportionately large amount of ERS work being set aside for small businesses with fewer than 500 employees, as some commenters maintained, the current size standard adversely affects larger businesses' ability to obtain work in the ERS market. They argued that the proposed higher size standard would help to establish balance and fairness in the Federal ERS market. Some stated that increasing the size standard would increase the number of set-aside contracts for small businesses and decrease the number of contracts under full and open competition.

The commenters stated that the higher size standard would increase the number of small businesses and allow the government to increase the number and size of small business set-aside contracts. They stated that no individual firm at the 1,250-employee size standard would dominate the ERS industry and that the number of firms that would become small under the proposed higher size standard would be insignificant relative to total firms in the ERS industry. One commenter stated that the increased size standard would not affect 8(a) businesses, HUBZone businesses, SDVOSBs, or WOSBs. Some argued that the higher size standard would provide small businesses with more opportunities to compete for a larger share of the Federal ERS market.

Some commenters noted that by increasing small business participation and job creation, the higher size standard would promote the Jobs Act initiative, while others stated that by increasing the pool of small businesses it would assist agencies to meet their small business contracting goals. Others argued that it would ensure that the government has an adequate pool of small businesses and it would increase competition in the small business ERS market and provide greater value for the dollars awarded to small businesses.

Some commenters pointed out that firms under 500 employees lack the capacity to handle the increasing volume, complexity, and size of ERS contracts. They added that mid-size firms have the capacity and expertise to

perform more complex and larger jobs, but cannot compete for those opportunities under the 500-employee size standard. With small businesses more than doubling their size under the proposed size standard, there would be a corresponding increase in small business capabilities, they argued. Another commenter stated that many agencies solicit work under performance based remediation contracts, under which the prime contractor assumes all risk. Current small businesses under the 500-employee size standard are not in a position, according to the commenter, to undertake these risks, but the increased size standard would allow small businesses to assume those risks. The commenter added that because of the requirements, "small businesses often end up serving as pass through for work that is ultimately performed by large businesses."

One currently large company supporting SBA's proposal to increase the size standard believed that the size standard for ERS should be even higher at 1,500 employees. The commenter argued that its size is "disadvantaged" vis a vis both "mega" firms and small businesses. With mergers and acquisitions driving up the average size of businesses in the industry, the definition of a small business should increase as well, the commenter concluded. Among the others supporting SBA's proposal, one suggested delaying the adoption of the revised size standard by 12 months to allow companies to plan and prepare to compete with larger companies. Another suggested adding nuclear remediation services to the ERS definition because remediation of nuclear materials is a significant part of Federal ERS contracts, while another recommended including regulatory compliance.

#### *SBA's Response*

SBA is not adopting 1,500 employees as the size standard for ERS as suggested by one of the commenters for several reasons. First, besides consolidation in the ERS, the commenter did not provide specific data or analysis supporting the suggested 1,500-employee size standard. Second, the industry and Federal procurement data SBA analyzed in the proposed rule and in this final rule does not support a 1,500-employee size standard for ERS. Third, SBA is concerned that a 1,500-employee size standard would put many small ERS firms at a significant competitive disadvantage in competing for Federal opportunities. SBA does not agree with the suggestion from another commenter to delay the adoption of the revised size

standard for ERS by 12 months. The revised size standard that SBA adopts in the final rule becomes effective after 30 days from the date of publication of the final rule in the **Federal Register**.

Delaying the effective date would hurt other businesses that would benefit from the timely adoption of a revised size standard. Some commenters suggested that nuclear remediation and regulatory compliance be included under the ERS definition. SBA believes that nuclear remediation is already covered under “containment, remedial action, and removal and storage of contaminated materials” of the current definition. Similarly, the term “regulatory compliance” is very broad to include under the ERS definition. Thus, SBA is not adopting these changes.

*Comments Opposing SBA’s Proposal To Increase the ERS Size Standard to 1,250 Employees*

Commenters that were opposed to the proposed increase of the ERS size standard to 1,250 employees provided several reasons to support their positions. First, the commenters contended that the current ERS market is competitively fair under the 500-employee size standard, which was SBA’s goal when it established the ERS exception and the 500-employee size standard in 1994. They argued that there is no need for an increase to the size standard for ERS because agencies already have a sufficiently large and robust pool of highly qualified and experienced small businesses with the capacity, capability, and reach to meet their environmental remediation requirements. The commenters stated that this is proven by the successful performance of partial and total small business set-asides under various multiple award task order contracts (MATOCs) and single award task order contracts (SATOCs) under the ERS exception. They added that most ERS contracts rarely require resources of a company with more than 500 employees. Some stated that Federal clients are not adversely affected by the existing 500-employee size standard. The commenters noted that, during 2009–2013, 37–39 percent of ERS dollar awards were made to small businesses, as compared to the Federal government’s small business contracting goal of 23 percent. They stated that it is rare that an agency receives less than a dozen bids on contracting opportunities set aside for small businesses. One commenter stated that the 500-employee size standard has worked well for all these years and it provides robust competition and significant cost savings

to the government. The commenters also maintained that the majority of small businesses are below 250 employees, suggesting that they have plenty of room to grow under the current size standard. Some explained that businesses with 500 or fewer employees represent 77 percent of total firms registered in the System for Award Management (SAM) under NAICS 562910. They added that up to 90 percent of the industry would qualify as small under the proposed size standard.

Second, the commenters argued that the environmental remediation services industry is in decline and that present and future requirements do not support the proposed increase to the ERS size standard. They alleged that SBA failed to consider this factor when proposing the increase. They stated that most sites identified in earlier decades have already been remediated or restored and fewer new sites are being designated. For example, as the commenters stated, of the more than 38,000 sites under DoD’s restoration programs more than 29,000 are now in monitoring status or complete. The commenters added that Federal government spending on ERS work is down 42 percent in the last five years, and the average sizes of ERS contracts have decreased as well. They argued that to raise the size standard for an industry that is declining runs counter to the reality of the market. One commenter argued that expansion of the size standard when the Federal market is declining would harm those firms that have dedicated resources to support the Federal government as small businesses.

Third, a number of commenters expressed several concerns with SBA’s analysis and the data it used in the proposed rule. The commenters contended that, by including very big and highly diversified firms for which ERS is not a major source of revenue, SBA’s analysis inflated the average size, four-firm concentration and Gini coefficient of firms in this industry, and in turn inflated the size standard. Referring to the data on the top 200 environmental companies from *Engineering News-Record* (<http://enr.construction.com>), several commenters argued that most of the large businesses receiving contracts under NAICS 562910 have only a minor percentage of their employees participating in ERS work. Others argued that SBA evaluated all firms in NAICS 562910, instead of a subset of firms that are primarily engaged in the ERS activity. As a result, they argued, comparisons with anchor industry groups are unfair and not statistically valid. They recommended that SBA

should either use the data on the number of employees associated with the ERS activity only or data on firms for which ERS is their primary industry. The Economic Census, SAM and FPDS–NG data do not depict an accurate picture of the ERS industry as they do not differentiate between small ERS firms and larger, more diverse firms, they added. One commenter noted that FPDS–NG may not capture the sufficient picture of the ERS industry, because it does not reflect subcontracting dollars. Some commenters suggested that SBA should use alternative data, such as market research and “sources sought” data from Department of Defense (DoD), Department of Energy (DoE), and Environmental Protection Agency (EPA).

One commenter attributed the high Gini coefficient value to limiting the analysis to two PSCs that SBA used in defining ERS contracts and to including the contract awards data under the American Recovery and Reinvestment Act of 2009 (ARRA). The commenter noted that the two PSCs SBA selected represented only 38 percent of dollar awards during 2009–2011, while the government used 716 PSCs under NAICS 562910 in 2009–2013. The commenter stated that 21 percent of contract dollars in ERS for 2009–2011 were awarded under ARRA, of which 24 percent were awarded to small businesses compared to 57 percent of non-ARRA awards. The commenter suggested excluding ARRA funds from the analysis and increasing the weight of the Federal contract factor five to ten times. In view of the sensitivity of the average firm size to size and number of firms, some commenters suggested using the median firm size instead of the average.

Fourth, many commenters expressed concerns that the proposed 1,250-employee size standard would allow more successful mid-sized and large businesses with significant financial capacity and resources to dominate the ERS small business market, thereby rendering the majority of businesses with fewer than 500 employees unable to compete for Federal opportunities. They added this would cause irreparable damage to existing and emerging small businesses that need SBA’s support the most. They noted that this would be contrary to SBA’s mission to aid, counsel, assist and protect small business interests. The higher size standard would mainly promote the interests of a very few larger, well-established businesses above 500 employees at the expense of many small businesses under 500 employees, the commenters added. One commenter

argued that increasing the size standard would decrease small business participation because this would discourage small businesses from competing for small business contracts as the market would be crowded with significantly larger players. A few commenters maintained that small businesses are already faced with difficulty in competing against companies with 500 employees, and if the size standard is increased to 1,250 employees they would go out of business. Some commenters noted that the higher size standard would not change the dominance of very large companies on unrestricted competitions, but, by increasing the number of small businesses, it would increase competition for set-asides. Some believed that with a larger pool of small businesses under the higher size standard more contracts would be set aside with no subcontracting requirements, thereby reducing subcontracting opportunities for some small businesses. Small businesses, according to some commenters, are reluctant to bid on unrestricted contracts, because those contracts are usually too large to take on without a large business partner. Raising the size standard would allow large businesses to compete on their own without the need for small business partners, they argued.

#### *SBA's Response*

With respect to commenters' concerns with including diversified firms in the analysis, SBA believes that, because by definition ERS procurements are composed of activities in three or more separate industries with separate NAICS codes, companies involved in ERS work are likely to be diversified. The FPDS-NG data depicts that companies receiving ERS contracts under NAICS 562910 have also received contracts under other NAICS codes. Accordingly, focusing on the data on firms that are primarily engaged in one of those activities may not provide an accurate and complete picture of the ERS sub-industry. Additionally, there really does not exist any data source for firms that are primarily engaged in ERS work. For example, as explained in the proposed rule, the Economic Census data for NAICS 562910 reflect all firms involved in remediation services, but not specifically those in the ERS sub-industry. Similarly, as the commenters have noted, SAM and FPDS-NG data also do not accurately reflect a company's primary industry. While many commenters expressed concerns with the Economic Census, SAM, and FPDS-NG data for evaluating the ERS

sub-industry, the majority of them suggested no alternative data sources. A few suggested using the market research and sources sought data from Federal agencies. SBA is not aware that such data is stored or available, nor is it necessarily complete, since each contracting officer may conduct market research in a different way, and firms respond to sources sought notices in different ways, or sometimes not at all based on various factors.

While SBA agrees with the commenters that the presence of large firms would affect the magnitude of industry factors and supported size standards, it disagrees with their argument that large firms should be excluded from the analysis if ERS is not their primary activity. Even if ERS is not their primary activity in terms of its contribution to their total revenue or employment, large firms can have significant competitive advantage in the market over their smaller counterparts. For example, a 10,000-employee company, even if only 2.5 percent of its workforce (or 250 employees) is engaged in the ERS activity, would have a significant competitive edge over a 500-employee company that only performs ERS work, due to its considerable resources and economies of scale. However, in response to the comments, in this final rule SBA has updated its analysis of industry and Federal contracting factors for the ERS sub-industry by using more recent data for fiscal years 2012–2014 and by excluding the largest firms for which ERS work was not a significant source of their Federal revenues. This also addresses concerns from some commenters that the 2009–2011 data SBA used in the proposed rule were influenced by ARRA funds and the results in the proposed rule were not comparable to the Economic Census.

SBA also disagrees with the commenters' suggestion that SBA should only consider the number of employees associated with the ERS activity when a company operates in multiple NAICS codes. For size standards purposes, SBA defines business size in terms of total employees or receipts for the overall company, not based on employees or receipts associated with individual NAICS codes. Additionally, none of the data sources SBA considers in its size standards analysis (such as Economic Census, SAM, and FPDS-NG) would provide employees or receipts broken down by NAICS code or type of work performed.

The argument by some commenters that the SBA's analysis focused on all firms in NAICS 562910 is not correct.

As explained in the proposed rule, SBA analyzed only about 700 firms receiving Federal contracts for environmental remediation services during fiscal years 2009–2011, as compared to more than 3,000 firms in NAICS 562910 from the 2007 Economic Census, nearly 9,300 firms registered in SAM (as of March 2015), and about 1,700–1,800 firms receiving Federal contracts during fiscal years 2012–2014 under that NAICS code. On the other hand, analyses from other commenters applied to total NAICS 562910, instead of the ERS sub-industry. For example, some noted that 77 percent of firms in NAICS 562910 are below 500 employees and that would increase to 90 percent if the size standard is increased to 1,250 employees. For the majority of industries, the current size standards cover 90–95 percent of firms. Thus, even if the 1,250-employee size standard would include 90 percent firms within the ERS sub-industry, that would not be inconsistent with most other industries. One commenter argued that the two PSCs SBA used to identify the ERS contracts accounted for only 38 percent of awards in NAICS 562910, but did not specify what other PSCs SBA should consider in identifying the ERS contracts. SBA agrees that there exist a large number of other PSCs associated with contracts under NAICS 562910, but it should be noted that they all do not apply to ERS contracts. The FPDS-NG data for fiscal years 2012–2014 show 432 PSCs under NAICS 562910, significantly fewer than 716 PSCs suggested by the commenter. SBA selected the two PSCs based on its thorough review of contract awards data on FPDS-NG.

In response to comments that the Federal ERS market has been in decline, SBA examined Federal contracting trends under NAICS 562910 for fiscal years 2001–2014 using the data from FPDS-NG. Total contract dollars for overall NAICS 562910 showed continuous growth from a little above \$1.0 billion in 2001, peaking at a little over \$7.0 billion in 2009 in conjunction with the ARRA. Since then annual contract dollars for NAICS 562910 have remained at about the same level as that for several pre-ARRA years. Similarly, total dollar awards under the two PSCs (*i.e.*, F108 and F999) that SBA used to identify ERS contracts also showed a similar trend. That is, total dollars under ERS contracts also showed continuous growth, increasing from nearly \$0.64 billion in 2001 to nearly \$2.0 billion in 2009. ERS contract dollars declined during fiscal years 2010–2011, but bounced back averaging

a little over \$2.0 billion during fiscal years 2012–2014. Although the growth in Federal ERS market has slowed and seen some ups and downs in recent years, these trends do not necessarily support the argument that the ERS industry is shrinking.

*Comments Supporting SBA's Proposed Size Standards in General*

An association representing small business investment companies (SBICs) applauded SBA's effort to review and increase size standards for the 30 industries covered by the proposed rule. The association also supported SBA's approach to maintaining the current size standards for 24 industries. Specifically, it supported the proposed increases to size standards in the Mining, Freight Transportation and Publishing and Technology Sectors because SBICs have substantial investments in those sectors. The association noted that proposed size standards increases will expand investment opportunities for SBICs and promote job creation and suggested that SBA should review and update size standards on a regular basis.

*Comments Opposing SBA's Proposed Size Standards in General*

One commenter opposed SBA's proposed increases to size standards. The commenter argued that instead of focusing on the 98 percent of businesses that are truly small businesses, SBA is focusing on the 2 percent of the largest corporations and classifying them as small businesses so that they can take business and loans away from truly small businesses. The commenter added that SBA's small business definitions are much larger than those used by other countries (such as Australia and European Union) and by the U.S. Congress, for example, for the Affordable Health Care Act. The commenter further stated that since 2008, SBA, by expanding small business definitions, has allowed more than 74,000 larger corporations to be classified as small. The commenter claimed that the average size of SBA's loan increased from \$185,000 in 2008 to \$534,000 in 2013, while the share of loans under \$100,000, which the commenter claimed generally go to truly small businesses, decreased from 24 percent to 9 percent. The commenter used these statistics to conclude that the expansion of small business size definitions has excluded truly small businesses from SBA's loans programs. Lastly, the commenter claimed that large corporations that qualify as small under the expanded definition of small businesses will take away government

contracts from truly small businesses that SBA is supposed to be supporting.

*SBA's Response*

SBA acknowledges that some of its proposed size standards could include as much as 97 percent to 99 percent of firms in a given industry. However, it is very important to point out that while it may appear to be a large segment of an industry in terms of the percentage of firms, small firms in those industries represent only about a third of total industry receipts.

What constitutes a small business in other countries does not apply and has no relevance to SBA's small business definitions and U.S. Government programs that use them. Depending on their economic and political realities, other countries have their own programs and priorities that can be very different from those in the U.S. Accordingly, small business definitions other countries use for their government programs can be vastly different from those established by SBA for U.S. Government programs. From time to time, the U.S. Congress has used different thresholds, sometimes below the SBA's thresholds, to define small firms under certain laws or programs, but those thresholds apply only to those laws and programs and generally are of no relevance to SBA's size standards. SBA establishes size standards, in accordance with the Small Business Act, for purposes of establishing eligibility for Federal small business procurement and financial assistance programs. The primary statutory definition of a small business is that the firm is not dominant in its field of operation. Accordingly, rather than representing the smallest size within an industry, SBA's size standards generally designate the largest size that a business concern can be relative to other businesses in the industry and still qualify as small for Federal government programs that provide benefits to small businesses.

The commenter's figures on average loan size for 2008 and 2013 are not correct. Based on numbers and amounts of loans issued under SBA's 7(a) and CDC/504 loan programs, the average loan size increased from about \$230,500 in 2008 to about \$426,900 in 2013, rather than from \$185,000 to \$534,000 as claimed by the commenter.

SBA does not agree that increases in average loan amounts and decreases in smaller loans are solely due to the increases in size standards for two reasons. First, with the passage of the Jobs Act in 2010, Congress increased the limits for SBA's 7(a) loans from \$2 million to \$5 million, for CDC/504 loans

from \$1.5 million to \$5.5 million, and for SBA Express loans made during the one year period following the Jobs Act from \$350,000 to \$1 million. Second, at the same time, Congress also increased the tangible net worth and net income limits of the alternative size standard from \$8.5 million and \$3 million to \$15 million and \$5 million, respectively. Under the alternative size standard, businesses that are above their industry size standards can qualify for SBA's loans. These statutory changes are important factors behind the increase in the average size of an SBA loan. However, such changes do not necessarily mean that truly small businesses are getting fewer loans now than in 2008. In fact, businesses with less than 10 employees received a total of \$12.1 billion in loans through SBA's 7(a) and 504 programs in 2014, as compared to \$10.6 billion in 2008. That was an increase of more than 14 percent.

With respect to the claim that large corporations that qualify as small under the expanded definition of small businesses will take away government contracts from truly small businesses, the commenter did not provide any supporting data.

**Analyses and Conclusions**

*ITVAR Industry Analysis*

In the 2003 final rule, SBA used a hybrid approach to create and evaluate the ITVAR exception. Specifically, based on the assumption that ITVARs operate in NAICS Industry Group 5415 (Computer System Design and Related Services) and in NAICS 423430 (Computer and Computer Peripheral Equipment and Software Merchant Wholesalers), SBA used the 1997 Economic Census data and combined part of NAICS Industry Group 5415 with part of NAICS 423430 and defined the result as the ITVAR industry and used it as the basis to establish the characteristics of ITVAR firms. As discussed elsewhere in this final rule, SBA now finds several problems with that approach. First, there is no need to create the ITVAR industry in that manner because, based on their primary activity of selling computer hardware and software, ITVARs are included in NAICS 423430. Accordingly, SBA now believes the industry data for NAICS 423430 alone would provide a more accurate description of ITVAR firms than the hybrid approach, especially given significant differences in economic structure between firms in NAICS Industry Group 5415 and ITVAR firms, as suggested by the Economic Census data and also confirmed by

many commenters. Second, in combining the two industry categories, the sale of computer hardware and software segment of NAICS 423430 was excluded even if that segment accounted for more than 80 percent of total receipts of that industry. Many commenters also argued that the sales of computer hardware and software account for the majority of receipts of ITVAR firms. SBA has determined that had the computer hardware and software segment been included, the analysis would have supported the same 500-employee nonmanufacturer size standard for ITVAR firms as well. Third, by construction, the ITVAR exception applies to procurements that are predominantly supply contracts, yet the 2003 final rule included it as an exception to NAICS 541519, which is a services NAICS code. For these reasons, in this final rule, SBA is not adopting the 2003 hybrid approach although some commenters suggested using the same approach to evaluate the ITVAR exception and its 150-employee size standard.

SBA's analysis in this final rule is based on the premise that ITVARs are basically wholesalers and supply computer hardware and software as nonmanufacturers and that all firms in Wholesale Trade (NAICS Sector 42)

share the same 500-employee size standard for purposes of Federal procurement of supplies under the NMR. Thus, any size standard exception to the ITVARs, if warranted, should be addressed within the context of the NMR.

In response to the comments and reevaluation of all available industry and Federal procurement data relating to the ITVAR exception, SBA analyzed economic characteristics of ITVAR firms and their size standard using two data sources. The first is the 2007 Economic Census data (the latest available) for NAICS Sector 42, including NAICS 423430. Second is the FPDS-NG and small business goaling data on firms receiving contracts under the ITVAR exception to NAICS 541519 during fiscal years 2012–2014. SBA also looked at the data from USASpending ([www.usaspending.gov](http://www.usaspending.gov)), but business size information of some contractors was found to be outdated. Therefore, for Federal procurement data SBA relied on FPDS-NG and small business goaling data, and relied on SAM for business size data.

As stated in the proposed rule, the Economic Census industry data are limited to the 6-digit NAICS codes and do not provide economic characteristics for the exception. As explained above

and also noted in the 2003 final rule, based on their primary activity, ITVARs are classified under NAICS 423430 in Wholesale Trade Sector (NAICS Sector 42). Given that ITVARs are part of one of the industries in Wholesale Trade and that the current size standard for Federal procurement of supplies for all firms in the Wholesale Trade sector is 500 employees under the NMR, SBA believes it is pertinent to examine the characteristics of ITVAR firms relative to those for other industries in the sector to determine if a different size standard is appropriate for ITVAR firms. For this, using the 2007 Economic Census data, SBA ranked all industries in NAICS Sector 42 based on each industry factor and placed them in one of the five ranked quintiles (*i.e.*, less than the 20th percentile, the 20th to less than the 40th percentile, the 40th to less than the 60th percentile, the 60th to less than the 80th percentile, and the 80th or higher percentile). The quintile ranges of values for each industry factor are shown in Table 1, "Values of Industry Factors for NAICS Sector 42 by Quintile." The second row from the bottom shows the values for firms in NAICS 423430, while values for industry factors for NAICS 541519 are in the last row for comparison.

TABLE 1—VALUES OF INDUSTRY FACTORS FOR NAICS SECTOR 42 BY QUINTILE

Quintile	Percentile (%)	Simple average firm size (number of employees)	Weighted average firm size (number of employees)	Average assets size (\$million)	Average number employees of largest four firms	Gini coefficient
1st quintile .....	<20% .....	<13.5 .....	<78.0 .....	<2.8 .....	<700.0 .....	<0.680
2nd quintile .....	20% to <40% .....	13.5 to <17.0 .....	78.0 to <141.0 .....	2.8 to <4.5 .....	700.0 to <1,096.3 .....	0.680 to <0.731
3rd quintile .....	40% to <60% .....	17.0 to <20.8 .....	141.0 to <202.8 .....	4.5 to <6.5 .....	1,096.3 to <1,648.8 .....	0.731 to <0.786
4th quintile .....	60% to <80% .....	20.8 to <26.0 .....	202.8 to <448.9 .....	6.5 to <8.8 .....	1,648.8 to <4,034.3 .....	0.786 to <0.844
5th quintile .....	≥80% .....	≥26.0 .....	≥448.9 .....	≥8.8 .....	≥4,034.3 .....	≥0.844
NAICS Sector 42 (total) .....		18.7 .....	606 .....	5.4 .....	7,562 .....	0.814
NAICS 423430 .....		36.0 .....	1,249 .....	8.8 .....	25,321 .....	0.891
NAICS 541519 .....		10.2 .....	283 .....	0.6 .....	3,860 .....	0.756

As can be seen from the above table, NAICS 423430 falls in the fifth or highest quintile for all industry factors. This means that for all factors NAICS 423430 ranked above more than 80 percent of the industries in Sector 42. Thus, the data do not support a lower size standard for firms in NAICS 423430 than for other industries in the sector. In other words, the current 150-employee size standard for ITVARs is inconsistent with their characteristics as compared to the characteristics of firms in other wholesale trade industries for which the size standard for Federal

procurement is 500 employees. In the proposed rule, published on May 19, 2014 (79 FR 28631), SBA proposed retaining the current 500-employee size standard for procurement of supplies under the NMR. Additionally, the results also depict that firms in NAICS 423430 differ from those in NAICS 541519.

To determine characteristics of ITVAR firms and the impact of SBA's proposal, many commenters recommended that SBA evaluate the data on employees and receipts of firms receiving contracts under various GWACs (*e.g.*, DHS's

FirstSource I/II, Air Force's NETCENTS-2, Army's ITES-3H, NASA's SEWP IV/V, and NIH's CIO-CS) which, according to the commenters, have used the ITVAR exception and 150-employee size standard. However, the review of the FPDS-NG data showed that, of various GWACs suggested by the commenters, only DHS's FirstSource I/II and NASA's SEWP IV/V used the ITVAR exception and 150-employee size standard. Among others, no awards have been made yet under NIH's CIO-CS and Army's ITES-3H. Their predecessor programs used

manufacturing NAICS codes. Specifically, NIH's ECS-3 used NAICS 334111, while Army's ITES-2H mostly used NAICS 334111, 334112 and 334119. Air Force's NETCENTS-2 used NAICS 334210. Additionally, based on review of FPDS-NG data and various GSA supply schedules, SBA found that agencies have also procured new computer and networking hardware through GSA's Schedule 70 SIN 132-8 using NAICS 541519.

SBA examines the data from SAM, small business goaling statistics and FPDS-NG to evaluate all exceptions and industries that are not covered by the Economic Census. Accordingly, using the FPDS-NG and small business goaling data, SBA identified 259 unique firms that received contracts under DHS's FirstSource I and II, NASA's SEWP IV and V, and GSA's Schedule 70 SIN 132-8 using the ITVAR exception to NAICS 541519 during fiscal years 2012-2014. By program, 37 firms received contracts under FirstSource I and II, 174 firms under SEWP IV and V, and 111 firms under Schedule 70. These figures add up to more than 259 firms because some firms received contracts under more than one program. SBA obtained latest information on average annual receipts and number of employees of those firms from their SAM profiles. Of

those 259 unique firms, SBA excluded some very large manufacturing firms for which the ITVAR activity was not a major source of their Federal revenues, as well as others with missing or questionable employee and revenue information, yielding a total of 231 firms. This group of firms still contained quite large firms for which the ITVAR activity did not appear to be a major source of their Federal revenues. To prevent such large firms from skewing the results and obtain a more representative group of ITVAR firms, SBA further excluded 7.5 percent of the largest firms based on number of employees and another 5 percent of the largest firms based on revenue, resulting in a total of 204 firms. SBA analyzed the employee and revenue data on these firms to establish industry characteristics of ITVAR firms in terms of average size, industry concentration, and distribution by size. Firms that received contracts under NASA's SEWP V did not yet have dollars awarded to them. Thus, SBA excluded those firms when calculating the Federal contracting factor (*i.e.*, the difference between small business share of total industry receipts and the similar share of total contracts dollars). SBA derived the size standard for each factor using the methodology for employee based

size standards that the Agency used in the proposed rule. These results along with supported size standards by each of those factors are provided in Table 2 "Size Standards Supported by Each Factor for Firms Receiving ITVAR Contracts (No. of Employees)," below. As shown in the table, the results support a 500-employee size standard for ITVAR firms.

Many commenters expressed concerns about having to compete with larger ITVARs if the ITVAR exception is eliminated and ITVAR contracts are reclassified under the manufacturing NAICS codes, thereby subjecting them to the 500-employee nonmanufacturer size standard. To validate these concerns, SBA analyzed characteristics of firms receiving computer hardware and software contracts under NIH's ECS-3, NASA's SEWP IV, Army's ITES-2H, and GSA's Schedule 70 SIN 132-8 that used the manufacturing codes under Industry Group 3411 (Computer and Peripheral Equipment Manufacturing), NAICS 423430 (Computer and Computer Peripheral Equipment and Software Merchant Wholesalers), or NAICS 443142/443120 (Electronic Stores (NAICS 2012)/ Computer and Software Stores (NAICS 2007)).

TABLE 2—SIZE STANDARDS SUPPORTED BY EACH FACTOR FOR FIRMS RECEIVING ITVAR CONTRACTS  
[Number of employees]

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
NAICS Code/GWAC Program	Simple average firm size (number of employees)	Weighted average firm size (number of employees)	Average assets size (\$million)	Four-firm ratio (%)	Four-firm average size (number of employees)*	Gini coefficient	Federal contract factor (%)	Calculated size standard (number of employees)	Current size standard (number of employees)
ITVAR Exception, 541519 .....	63	298	\$9.5	11.3	NA	0.359	23.0	500	150
NASA SEWP IV and V, DHS First Source I and 2, and GSA Schedule 70 SIN 132 8	500	500	500			500	150		
3341, 423430 and 443142/443120 ....	57	438	\$7.1	11.3	NA	0.519	3.2	500	500
NASA SEWP IV, NIH ECS-3, ARMY ITES-2H, and GSA Schedule 70 SIN 132-8	500	750	500			500	500		

\* Size standard for four-firm average size is not calculated as the four-firm ratio is less than 40%.

Using the FPDS-NG and small business goaling data, SBA identified 446 unique firms that received contracts during fiscal years 2012-2014 through those programs using NAICS Industry Group 3411, NAICS 423430, and NAICS 443142/443120. After the exclusion of manufacturing firms and very large firms for which the sales of computer hardware and software was not a major source of their Federal revenue, as well

as others with missing or questionable employee and revenue information, there remained 421 firms. This group of firms still included some large firms for which computer hardware and software contracts did not appear to be a principal source of their Federal sales. To prevent such large firms from biasing the results, SBA further removed 7.5 percent of the remaining largest firms based on the number of employees and

another 5 percent based on revenue, yielding a total of 371 firms. Using these firms, SBA derived industry factors (*e.g.*, average size, average assets, industry concentration, and the Gini coefficient) and Federal contracting factor and supported size standards using the "SBA's Size Standards Methodology" (available at [www.sba.gov/size](http://www.sba.gov/size)) used in the proposed rule. These results are also shown in

Table 2, “Size Standards Supported by Each Factor for Firms Receiving ITVAR Contracts (No. of Employees), above. The results on individual factors and size standards supported by them do not seem to suggest that firms receiving computer hardware and software contracts under the manufacturing NAICS codes are larger than those receiving similar contracts under the ITVAR exception to NAICS 541519. The data from both groups of firms support the same 500-employee size standard for ITVARs.

Thus, based on the characteristics of firms in NAICS 423430 relative to those for all firms in NAICS Sector 42 and data on firms receiving computer hardware and software contracts both under the ITVAR exception and manufacturing NAICS codes, the data suggests that the size standard for ITVAR firms should be the same as the 500-employee nonmanufacturer size standard. However, in view of concerns from most commenters that with the elimination of the ITVAR exception small ITVARs with fewer than 150 employees would be forced to compete for Federal opportunities with large companies up to 500 employees under the 500-employee nonmanufacturer size standard, SBA has decided to leave the exception under NAICS 541519 with the 150-employee size standard.

As discussed elsewhere in this final rule SBA has determined that there is no legal basis to exclude ITVAR contracts, which by definition are primarily supply contracts, from the manufacturing performance requirements or the NMR. Accordingly, in this final rule, SBA has amended Footnote 18 by adding the requirement that the offeror on small business set-aside ITVAR contracts must comply with the manufacturing performance requirements or the NMR. That means products being supplied must be of a small business manufacturer made in the U.S., unless no small business manufacturers exist. If an agency determines that no small businesses manufacturers can be expected to meet requirements under a particular solicitation, they can request a waiver of the NMR, as discussed in more detail at 13 CFR 121.406 and 121.1204. This would eliminate the current confusion on the applicability of the manufacturing performance requirements or the NMR to the ITVAR

contracts. This would also eliminate inconsistency in the current regulations that exempt the ITVAR contracts from the manufacturing performance requirements or the NMR, even if by definition they are primarily supply contracts.

The current definition of the ITVAR exception in Footnote 18 also provides for eligibility of ITVARs for SBA’s financial assistance. For firms in NAICS Sectors 42 and 44–45, the applicable size standard for SBA’s financial assistance is the size standard for their primary industry. Accordingly, for SBA’s financial assistance, ITVARs will qualify under the industry-specific size standard for NAICS 423430, which SBA recently increased from 100 employees to 250 employees. Because this size standard is higher than the 150-employee ITVAR size standard and ITVARs that exceed the 150-employee size standard can still qualify for financial assistance under the tangible net worth and net income based alternative size standard, SBA does not see the need to include the eligibility requirement for SBA’s financial assistance under the ITVAR exception. SBA’s amendments to Footnote 18 to SBA’s table of size standards also reflect this change.

Given the above amendment to Footnote 18 to the table of size standards that the offeror on small business set-aside ITVAR contracts must comply with the manufacturing performance requirements or the NMR, SBA is also amending paragraph b(3) under 13 CFR 121.406 to provide that the NMR also applies to procurements that have been assigned the Information Technology Value Added Resellers (ITVAR) exception to NAICS code 541519. Similarly, SBA is also amending paragraph b(4) under 13 CFR 121.406 to provide that the NMR also applies to the supply component of a requirement classified as an ITVAR contract.

Finally, SBA is also amending introductory text in paragraph b(5) under 13 CFR 121.406 to correct a typo in paragraph citation from paragraph b(1)(iii) to paragraph b(1)(iv).

#### *ERS Industry Analysis*

In response to the comments, SBA reevaluated the methodology and data sources it used in the proposed rule. Specifically, in this final rule, SBA has

analyzed the data on firms receiving ERS contracts during fiscal years 2012–2014 and the 2014 top 200 environmental firms from *Engineering News-Record (ENR)* (<http://enr.construction.com/toplists/>) that some commenters provided. The review of the 2012–2014 Federal contracting data confirms that the two PSC codes SBA used in the proposed rule to identify ERS contracts were correct. SBA believes that this more recent data not only provides a better reflection of the ERS market conditions, but also addresses the commenters’ concerns for including ARRA funds in the 2009–2011 data used in the proposed rule. Additionally, in computing the industry and Federal contracting factors, SBA excluded the largest environmental firms for which ERS contracts did not appear to be a major source of their total revenues.

Using the FPDS–NG and small business goaling data, SBA identified 921 unique firms that received ERS contracts during fiscal years 2012–2014. With the exclusion of known non-environmental firms and those with missing or questionable employee and revenue information, there remained 882 firms. To prevent very large, diversified firms from biasing the results, SBA further excluded 5 percent of the largest firms for which ERS activity did not generally appear to be a principal source of their total sales. Additionally, using the information on the top 200 environmental firms from ENR that the commenters provided, SBA excluded five more very large firms for which environmental work (including both Federal and non-Federal) accounted for less than 25 percent of their total revenues. This yielded a total of 833 firms. SBA analyzed the employment and revenue data on these firms to obtain industry factors (e.g., average size, industry concentration, and the Gini coefficient) and the Federal contracting factor and supported size standards using the SBA’s size standards methodology used in the proposed rule. As in the proposed rule, SBA is unable to compute the average assets due to the lack of data. The results of this analysis are provided in Table 3, “Size Standards Supported by Each Factor for the ERS Sub-industry (No. of Employees),” below.

TABLE 3—SIZE STANDARDS SUPPORTED BY EACH FACTOR FOR THE ERS SUB-INDUSTRY  
[Number of employees]

	Simple average firm size (number of employees)	Weighted average firm size (number of employees)	Average assets size (\$ million)	Four-firm ratio (%)	Four-firm average size (number of employees) *	Gini coefficient	Federal contract factor (%)	Calculated size standard (number of employees)
Factor .....	89	492	NA	38.5	NA	0.749	10.1	750
Size standard .....	750	1,000	NA	.....	NA	500	500	.....

\* Size standard for four-firm average size is not calculated as the four-firm ratio is less than 40%.

Thus, based on the results above, in this final rule, SBA is adopting 750 employees as the size standard for the ERS exception under NAICS 562910. Based on FPDS-NG and SAM data, about 10–15 additional firms will gain small business status under the new 750-employee size standard for ERS. SBA believes that this will not have a significant impact on small businesses below the current 500-employee size standard.

*Exceptions Under NAICS 541712, Research and Development in the Physical, Engineering, and Life Sciences (Except Biotechnology)*

NAICS 541712, Research and Development in the Physical, Engineering, and Life Sciences (except Biotechnology), has three sub-industries or “exceptions.” As stated in Footnote 11 to SBA’s table of size standards, for research and development (R&D) contracts requiring the delivery of a manufactured product, the appropriate size standard is that of the corresponding manufacturing industry. To better match the exceptions under NAICS 541712 to the corresponding

proposed industry specific size standards in manufacturing, SBA proposed to modify the titles of the three exceptions. The Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment category was dropped from the third exception because the proposed size standard for the corresponding manufacturing industry (NAICS 336419) was the same as the proposed size standard for rest of NAICS 541712. In the absence of adverse comments, SBA is adopting the modified exceptions as shown in Table 4, “Modified Exceptions to NAICS 541712 and Their Revised Size Standards,” as proposed.

TABLE 4—MODIFIED EXCEPTIONS TO NAICS 541712 AND THEIR REVISED SIZE STANDARDS

Current		Proposed	
Exception	Size standard (number of employees)	Exception	Size standard (number of employees)
Aircraft .....	1,500	Aircraft, Aircraft Engine, and Engine Parts .....	1,500
Aircraft Parts and Auxiliary Equipment, and Aircraft Engine Parts.	1,000	Other Aircraft Parts and Auxiliary Equipment .....	1,250
Space Vehicles and Guided Missiles, Their Propulsion Units Parts, and Their Auxiliary Equipment and Parts.	1,000	Guided Missiles and Space Vehicles, Their Propulsion Units and Propulsion Parts.	1,250

Additionally, to eliminate possible confusion and provide more clarity, SBA also proposed to amend Footnote 11 by converting the introductory paragraph to a new sub-paragraph (b) and renaming existing sub-paragraphs (b) and (c) to sub-paragraphs (c) and (d), respectively. SBA is adopting the proposed amendments to Footnote 11 to BA’s table of size standards.

*Offshore Marine Air Transportation Services and Offshore Marine Services*

Offshore Marine Air Transportation Services is a sub-industry or “exception” under both NAICS 481211, Nonscheduled Chartered Passenger Air Transportation, and NAICS 481212, Nonscheduled Chartered Freight Air Transportation. The size standards are 1,500 employees for both NAICS codes 481211 and 481212 and \$30.5 million in average annual receipts for the exception. Similarly, as indicated in

Footnote 15 to SBA’s table of size standards, Offshore Marine Services is an exception to all industries under NAICS Subsector 483, Water Transportation, with the size standard of \$30.5 million in average annual receipts. All industries within Subsector 483 currently have a 500-employee size standard. SBA did not review the receipts based exceptions when it reviewed receipts based size standards in NAICS Sector 48–49, Transportation and Warehousing. For the reasons provided in the proposed rule, SBA proposed to eliminate both exceptions and their \$30.5 million receipts based size standard and only apply the applicable employee based size standard. As a result, SBA also proposed to eliminate Footnote 15 from SBA’s table of size standards. Since there were no comments against the proposed change, SBA is eliminating

both exceptions and their receipts based size standard, as proposed. This will not affect the eligibility of firms that are small under the \$30.5 million receipts based size standard because they will continue to be eligible under the employee based size standard.

**Conclusions**

Based on SBA’s analyses of the latest available industry and Federal market data and its evaluation of public comments on the proposed rule, in this final rule, SBA is adopting all proposed changes, with two exceptions. SBA is not adopting its proposed elimination of the ITVAR exception to NAICS 541519 or its proposed increase to the size standard for ERS exception to NAICS 562910 from 500 employees to 1,250 employees.

With regard to the ITVAR exception to NAICS 541519, in response to the comments, SBA retains the ITVAR

exception to NAICS 541519 with the 150-employee size standard. However, SBA amends Footnote 18 to SBA’s table of size standards by adding the requirement that the supply (*i.e.*, computer hardware and software) component of small business set-aside ITVAR contracts must comply with the manufacturing performance

requirements, or comply with the NMR by supplying the products of small business concerns, unless SBA has issued a class or contract specific waiver of the NMR. With regard to the ERS exception under NAICS 562910, based on its analysis of more recent data and evaluation of public comments, in this final rule, SBA increases the size

standard for the ERS exception from 500 employees to 750 employees, instead of the proposed 1,250 employees. All revisions adopted in this final rule are shown in Table 5, “Summary of Adopted Size Standards Revisions,” below.

TABLE 5—SUMMARY OF ADOPTED SIZE STANDARDS REVISIONS

NAICS code	NAICS industry title	Current size standard (millions of dollars)	Current size standard (number of employees)	Adopted size standard (number of employees)
211111	Crude Petroleum and Natural Gas Extraction		500	1,250
211112	Natural Gas Liquid Extraction		500	750
212111	Bituminous Coal and Lignite Surface Mining		500	1,250
212112	Bituminous Coal Underground Mining		500	1,500
212113	Anthracite Mining		500	250
212210	Iron Ore Mining		500	750
212221	Gold Ore Mining		500	1,500
212222	Silver Ore Mining		500	250
212231	Lead Ore and Zinc Ore Mining		500	750
212234	Copper Ore and Nickel Ore Mining		500	1,500
212291	Uranium-Radium-Vanadium Ore Mining		500	250
212299	All Other Metal Ore Mining		500	750
212312	Crushed and Broken Limestone Mining and Quarrying		500	750
212313	Crushed and Broken Granite Mining and Quarrying		500	750
212324	Kaolin and Ball Clay Mining		500	750
212391	Potash, Soda, and Borate Mineral Mining		500	750
212392	Phosphate Rock Mining		500	1,000
213111	Drilling Oil and Gas Wells		500	1,000
221210	Natural Gas Distribution		500	1,000
481211	Offshore Marine Air Transportation Services	\$30.5		Eliminate
Except,				
481212	Offshore Marine Air Transportation Services	30.5		Eliminate
Except,				
482112	Short Line Railroads		500	1,500
483112	Deep Sea Passenger Transportation		500	1,500
483113	Coastal and Great Lakes Freight Transportation		500	750
483211	Inland Water Freight Transportation		500	750
511110	Newspaper Publishers		500	1,000
511120	Periodical Publishers		500	1,000
511130	Book Publishers		500	1,000
511140	Directory and Mailing List Publishers		500	1,250
511191	Greeting Card Publishers		500	1,500
512220	Integrated Record Production/Distribution		750	1,250
512230	Music Publishers		500	750
519130	Internet Publishing and Broadcasting and Web Search Portals		500	1,000
541711	Research and Development in Biotechnology <sup>11</sup>		500	1,000
541712	Research and Development in the Physical, Engineering, and Life Sciences (except Biotechnology) <sup>11</sup> .		500	1,000
Except,	Aircraft Engine and Engine Parts		1,000	1,500
Except,	Other Aircraft Parts and Auxiliary Equipment		1,000	1,250
Except,	Guided Missiles and Space Vehicles, Their Propulsion Units and Propulsion Parts.		1,000	1,250
562910	Environmental Remediation Services		500	750
Except,				

*Evaluation of Dominance in Field of Operation*

SBA has determined that for the industries for which it is revising size standards in this final rule, no individual firm at or below the revised size standard will dominate its field of operation. Among the industries for which the size standards are revised in this rule, the small business share of

total industry receipts is, on average, 3.4 percent, with an interval showing a minimum of less than 0.01 percent to a maximum of 20.0 percent. These market shares effectively preclude a firm at or below the proposed size standards from exerting control over any of the industries.

*Compliance With Executive Orders 12866, 13563, 12988 and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35) and the Regulatory Flexibility Act (5 U.S.C. 601–612). Executive Order 12866*

The Office of Management and Budget (OMB) has determined that this final rule is a significant regulatory action for purposes of Executive Order 12866. Accordingly, in the next section, SBA

provides a Regulatory Impact Analysis of this rule. However, this rule is not a “major rule” under the Congressional Review Act, 5 U.S.C. 800.

#### *Regulatory Impact Analysis*

##### 1. Is there a need for the regulatory action?

SBA believes that the size standards adopted in this rule better reflect the economic characteristics of small businesses in the affected industries and the Federal government marketplace. SBA’s mission is to aid and assist small businesses through a variety of financial, procurement, business development, and advocacy programs. To determine the intended beneficiaries of these programs, SBA establishes distinct definitions of which businesses are deemed small businesses. The Small Business Act (15 U.S.C. 632(a)) delegates to SBA’s Administrator the responsibility for establishing small business definitions. The Act also requires that small business definitions vary to reflect industry differences. The Jobs Act also requires SBA to review all size standards and to make whatever adjustments are necessary to reflect market conditions. The supplementary information section of this rule explains SBA’s methodology for analyzing a size standard for a particular industry.

##### 2. What are the potential benefits and costs of this regulatory action?

The most significant benefit to businesses becoming small because of this rule is gaining or retaining eligibility for Federal small business assistance programs. These include SBA’s financial assistance programs, economic injury disaster loans, and Federal procurement programs intended for small businesses. Federal procurement programs provide targeted opportunities for small businesses under SBA’s business development programs, such as 8(a), Small Disadvantaged Businesses (SDB), small businesses located in Historically Underutilized Business Zones (HUBZone), women-owned small businesses (WOSB), economically disadvantaged women-owned small businesses (EDWOSB), and service-disabled veteran-owned small businesses (SDVOSB). Federal agencies may also use SBA’s size standards for a variety of other regulatory and program purposes. These programs assist small businesses to become more knowledgeable, stable, and competitive. SBA estimates that in 30 industries and three sub-industries (“exceptions”) for which it has increased size standards in this rule, more than 370 firms, not small

under the existing size standards, will become small under the revised size standards and eligible for these programs. That is about 0.5 percent of all firms classified as small under the current size standards in all industries and sub-industries reviewed in this rule. This should increase the small business share of total receipts in those industries from 18.3 percent to 21.3 percent. In the three industries for which reduced size standards apply, only the one or two largest firms will be impacted in each of them.

Three groups will benefit from the size standards revisions in this rule: (1) Some businesses that are above the current size standards may gain small business status under the higher size standards, thus enabling them to participate in Federal small business assistance programs; (2) growing small businesses that are close to exceeding the current size standards may retain their small business status under the higher size standards, thereby enabling them to continue their participation in the programs; and (3) Federal agencies will have a larger pool of small businesses from which to draw for their small business procurement programs.

SBA estimates that, based on Federal contracting data for fiscal years 2012–2014, firms gaining small business status under the revised size standards might receive Federal contracts totaling \$85 million to \$95 million annually under SBA’s small business, 8(a), SDB, HUBZone, WOSB, EDWOSB, and SDVOSB Programs, and other unrestricted procurements. The added competition for many of these procurements may also result in lower prices to the Government for procurements reserved for small businesses, but SBA cannot quantify this benefit.

Under SBA’s 7(a) and 504 Loan Programs, based on the fiscal years 2012–2014 data, SBA estimates up to about five SBA 7(a) and 504 loans totaling about \$2.0 million might be made to these newly defined small businesses under the revised size standards. Increasing the size standards will likely result in more small business guaranteed loans to businesses in these industries, but it is impractical to try to estimate exactly the number and total amount of loans. There are two reasons for this: (1) Under the Jobs Act, SBA can now guarantee substantially larger loans than in the past; and (2) as described above, the Jobs Act established a higher alternative size standard (\$15 million in tangible net worth and \$5 million in net income after income taxes) for business concerns that do not meet the size standards for their industry. Therefore,

SBA finds it difficult to quantify the actual impact of the revised size standards on its 7(a) and 504 Loan Programs.

Newly defined small businesses will also benefit from SBA’s Economic Injury Disaster Loan (EIDL) Program. Since this program is contingent on the occurrence and severity of a disaster in the future, SBA cannot make a meaningful estimate of this impact.

In addition, newly defined small businesses will also benefit through reduced fees, less paperwork, and fewer compliance requirements that are available to small businesses throughout the Federal government.

To the extent that those 375 newly defined additional small firms could become active in Federal procurement programs, the revisions to size standards may entail some additional administrative costs to the government as a result of more businesses being eligible for Federal small business programs. For example, there will be more firms seeking SBA’s guaranteed loans, more firms eligible for enrollment in the System of Award Management (SAM) database, and more firms seeking certification as 8(a) or HUBZone firms or qualifying for small business, WOSB, EDWOSB, SDVOSB, and SDB status. Among those newly defined small businesses seeking SBA’s assistance, there could be some additional costs associated with compliance and verification of small business status and protests of small business or other status. However, SBA believes that these added administrative costs will be minimal because mechanisms are already in place to handle these requirements.

Additionally, in some cases, Federal government contracts may have higher costs. With a greater number of businesses defined as small, Federal agencies may choose to set aside more contracts for competition among small businesses only rather than using full and open competition. The movement from unrestricted to small business set-aside contracting might result in competition among fewer total bidders, although there will be more small businesses eligible to submit offers. However, the additional costs associated with fewer bidders are expected to be minor since, by law, procurements may be set aside for small businesses or reserved for the 8(a), HUBZone, WOSB, EDWOSB, or SDVOSB Programs only if awards are expected to be made at fair and reasonable prices. In addition, there may be higher costs when more full and open contracts are awarded to HUBZone businesses that receive price evaluation preferences.

The new size standards may have some distributional effects among large and small businesses. Although SBA cannot estimate with certainty the actual outcome of the gains and losses among small and large businesses, it can identify several probable impacts. There may be a transfer of some Federal contracts from large businesses to newly eligible small businesses. Large businesses may have fewer Federal contract opportunities as Federal agencies decide to set aside more contracts for small businesses. In addition, some Federal contracts may be awarded to HUBZone businesses instead of large businesses since these firms may be eligible for a price evaluation preference for contracts when they compete on a full and open basis.

Similarly, some businesses defined small under the previous size standards may receive fewer Federal contracts due to increased competition from more businesses defined as small under the revised size standards. This transfer may be offset by a greater number of Federal procurements set aside for all small businesses. The number of newly defined and expanding small businesses that are willing and able to sell to the Federal government will limit the potential transfer of contracts from large and small businesses under the current size standards. SBA cannot estimate the potential distributional impacts of these transfers with any degree of precision.

The revisions to the employee based size standards for these 33 industries and three sub-industries are consistent with SBA's statutory mandate to assist small business. This regulatory action promotes the Administration's objectives. One of SBA's goals in support of the Administration's objectives is to help individual small businesses succeed through fair and equitable access to capital and credit, Government contracts, and management and technical assistance. Reviewing and modifying size standards, when appropriate, ensures that intended beneficiaries have access to small business programs designed to assist them.

#### *Executive Order 13563*

Descriptions of the need for this regulatory action and benefits and costs associated with this action including possible distributional impacts that relate to Executive Order 13563 are included in the Regulatory Impact Analysis under Executive Order 12866, above.

In an effort to engage interested parties in this action, SBA presented its size standards methodology (discussed

above under Supplementary Information) to various industry associations and trade groups. SBA also met with a number of industry groups and individual businesses to get their feedback on its methodology and other size standards issues. In addition, SBA presented its size standards methodology to businesses in 13 cities in the U.S. and sought their input as part of the Jobs Act tour. The presentation also included information on the latest status of the comprehensive size standards review and on how interested parties can provide SBA with input and feedback on its size standards review.

Additionally, SBA sent letters to the Directors of the Offices of Small and Disadvantaged Business Utilization (OSDBU) at several Federal agencies with considerable procurement responsibilities requesting their feedback on how the agencies use SBA's size standards and whether current size standards meet their programmatic needs (both procurement and non-procurement). SBA gave appropriate consideration to all input, suggestions, recommendations, and relevant information obtained from industry groups, individual businesses, and Federal agencies in preparing this rule.

The review of size standards in industries and sub-industries covered in this rule is consistent with Executive Order 13563, Section 6, calling for retrospective analyses of existing rules. The last comprehensive review of size standards occurred during the late 1970s and early 1980s. Since then, except for periodic adjustments for monetary based size standards, most reviews of size standards were limited to a few specific industries in response to requests from the public and Federal agencies. The majority of employee based size standards have not been reviewed since they were first established. SBA recognizes that changes in industry structure and the Federal marketplace over time have rendered existing size standards for some industries no longer supportable by current data. Accordingly, in 2007, SBA began a comprehensive review of its size standards to ensure that existing size standards have supportable bases and to revise them when necessary. In addition, the Jobs Act requires SBA to conduct a detailed review of all size standards and to make appropriate adjustments to reflect market conditions. Specifically, the Jobs Act requires SBA to conduct a detailed review of at least one-third of all size standards during every 18-month period from the date of its enactment and do a complete review of all size standards

not less frequently than once every 5 years thereafter.

#### *Executive Order 12988*

This action meets applicable standards set forth in Sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or preemptive effect.

#### *Executive Order 13132*

For purposes of Executive Order 13132, SBA has determined that this rule will not have substantial, direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, SBA has determined that this rule has no federalism implications warranting preparation of a federalism assessment.

#### *Paperwork Reduction Act*

For the purpose of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA has determined that this rule does not impose any new reporting or recordkeeping requirements.

#### *Final Regulatory Flexibility Analysis*

Under the Regulatory Flexibility Act (RFA), this final rule may have a significant impact on a substantial number of small businesses in the industries and sub-industries covered by this rule. As described above, this rule may affect small businesses seeking Federal contracts, loans under SBA's 7(a), 504 and Economic Injury Disaster Loan Programs, and assistance under other Federal small business programs.

Immediately below, SBA sets forth a final regulatory flexibility analysis (FRFA) of this rule addressing the following questions: (1) What are the need for and objective of the rule?; (2) What are SBA's description and estimate of the number of small businesses to which the rule will apply?; (3) What are the projected reporting, recordkeeping, and other compliance requirements of the rule?; (4) What are the relevant Federal rules that may duplicate, overlap, or conflict with the rule?; and (5) What alternatives will allow the Agency to accomplish its regulatory objectives while minimizing the impact on small businesses?

1. What are the need for and objective of the rule?

Changes in industry structure, technological changes, productivity growth, mergers and acquisitions, and updated industry definitions have changed the structure of many

industries reviewed for this rule. Such changes can be sufficient to support revisions to current size standards for some industries. Based on the analysis of the latest data available, SBA believes that the revised size standards in this final rule more appropriately reflect the size of businesses that need Federal assistance. The Jobs Act also requires SBA to review all size standards and make necessary adjustments to reflect market conditions.

2. What are SBA’s description and estimate of the number of small businesses to which the rule will apply?

SBA estimates that about 375 additional firms may become small because of increased size standards for the 30 industries and three sub-industries covered by this rule. That represents 0.5 percent of total firms that are small under the previous size standards in all industries reviewed by SBA in the September 10, 2014 proposed rule. This will result in an increase in the small business share of total industry receipts for those industries from 18.3 percent under the current size standards to 21.3 percent under the proposed size standards. In the three industries for which SBA has proposed to reduce their size standards, only the one or two largest firms will be impacted in each of those industries. The revised size standards will enable more small businesses to retain their small business status for a longer period. Many firms may have lost their eligibility and find it difficult to compete at current size standards with companies that are significantly larger than they are. SBA believes that revisions to size standards will have a positive competitive impact on existing small businesses and on those that exceed the size standards but are on the very low end of those that are not small. They might otherwise be called or referred to as mid-sized businesses, although SBA only defines what is small; other entities are other than small.

3. What are the projected reporting, recordkeeping and other compliance requirements of the rule?

The revised size standards impose no additional reporting or recordkeeping

requirements on small businesses. However, qualifying for Federal procurement and a number of other programs requires that businesses register in the SAM database and certify in SAM that they are small at least once annually. Therefore, businesses opting to participate in those programs must comply with SAM requirements. However, there are no costs associated with SAM registration or certification. Changing size standards alters the access to SBA’s programs that assist small businesses, but does not impose a regulatory burden because they neither regulate nor control business behavior.

4. What are the relevant Federal rules, which may duplicate, overlap or conflict with the rule?

Under § 3(a)(2)(C) of the Small Business Act, 15 U.S.C. 632(a)(2)(c), Federal agencies must use SBA’s size standards to define a small business, unless specifically authorized by statute to do otherwise. In 1995, SBA published in the **Federal Register** a list of statutory and regulatory size standards that identified the application of SBA’s size standards as well as other size standards used by Federal agencies (60 FR 57982 (November 24, 1995)). SBA is not aware of any Federal rule that would duplicate or conflict with establishing size standards.

However, the Small Business Act and SBA’s regulations allow Federal agencies to develop different size standards if they believe that SBA’s size standards are not appropriate for their programs, with the approval of SBA’s Administrator (13 CFR 121.903). The Regulatory Flexibility Act authorizes an agency to establish an alternative small business definition for purposes of that Act, after consultation with the Office of Advocacy of the U.S. Small Business Administration (5 U.S.C. 601(3)).

5. What alternatives will allow the Agency to accomplish its regulatory objectives while minimizing the impact on small entities?

By law, SBA is required to develop numerical size standards for establishing eligibility for Federal small business assistance programs. Other than varying size standards by industry and changing the size measures, no

practical alternative exists to the systems of numerical size standards.

**List of Subjects in 13 CFR Part 121**

Administrative practice and procedure, Government procurement, Government property, Grant programs—business, Individuals with disabilities, Loan programs—business, Reporting and recordkeeping requirements, Small businesses.

For the reasons set forth in the preamble, SBA amends 13 CFR part 121 as follows:

**PART 121—SMALL BUSINESS SIZE REGULATIONS**

■ 1. The authority citation for part 121 continues to read as follows:

**Authority:** 15 U.S.C. 632, 634(b)(6), 662, and 694a(9).

■ 2. Amend § 121.201 in the table “Small Business Size Standards by NAICS Industry” as follows:

- a. Revise the entries for “211111”, “211112”, “212111”, “212112”, “212113”, “212210”, “212221”, “212222”, “212231”, “212234”, “212291”, “212299”, “212312”, “212313”, “212324”, “212391”, “212392”, “213111”, “221210”, “482112”, “483112”, “483113”, “483211”, “511110”, “511120”, “511130”, “511140”, “511191”, “512220”, “512230”, “519130”, “541711”, “541712” introductory entry and first, second and third sub-entry, and “562910” sub-entry.”
- b. Amend the entry for “481211” by removing the sub-entry “Except,” “Offshore Marine Air Transportation Services” “\$30.5”.
- c. Amend the entry for “481212” by removing the sub-entry “Except,” “Offshore Marine Air Transportation Services” “\$30.5”.
- d. Amend the entry for “Subsector 483—Water Transportation” by removing superscript “15”.
- e. Revise Footnote 11.
- f. Remove Footnote 15 and reserve Footnote 15.
- g. Revise Footnote 18.

The revisions read as follows:

**§ 121.201 What size standards has SBA identified by North American Industry Classification System codes?**

**SMALL BUSINESS SIZE STANDARDS BY NAICS INDUSTRY**

NAICS codes	NAICS U.S. industry title	Size standards in millions of dollars	Size standards in number of employees
211111	Crude Petroleum and Natural Gas Extraction		1,250

## SMALL BUSINESS SIZE STANDARDS BY NAICS INDUSTRY—Continued

NAICS codes	NAICS U.S. industry title	Size standards in millions of dollars	Size standards in number of employees
211112	Natural Gas Liquid Extraction		750
*	*	*	*
212111	Bituminous Coal and Lignite Surface Mining		1,250
212112	Bituminous Coal Underground Mining		1,500
212113	Anthracite Mining		250
212210	Iron Ore Mining		750
212221	Gold Ore Mining		1,500
212222	Silver Ore Mining		250
212231	Lead Ore and Zinc Ore Mining		750
212234	Copper Ore and Nickel Ore Mining		1,500
212291	Uranium-Radium-Vanadium Ore Mining		250
212299	All Other Metal Ore Mining		750
*	*	*	*
212312	Crushed and Broken Limestone Mining and Quarrying		750
212313	Crushed and Broken Granite Mining and Quarrying		750
*	*	*	*
212324	Kaolin and Ball Clay Mining		750
*	*	*	*
212391	Potash, Soda, and Borate Mineral Mining		750
212392	Phosphate Rock Mining		1,000
*	*	*	*
213111	Drilling Oil and Gas Wells		1,000
*	*	*	*
221210	Natural Gas Distribution		1,000
*	*	*	*
481211	Nonscheduled Chartered Passenger Air Transportation		1,500
481212	Nonscheduled Chartered Freight Air Transportation		1,500
*	*	*	*
482112	Short Line Railroads		1,500
<b>Subsector 483—Water Transportation</b>			
*	*	*	*
483112	Deep Sea Passenger Transportation		1,500
483113	Coastal and Great Lakes Freight Transportation		750
*	*	*	*
483211	Inland Water Freight Transportation		750

SMALL BUSINESS SIZE STANDARDS BY NAICS INDUSTRY—Continued

NAICS codes	NAICS U.S. industry title	Size standards in millions of dollars	Size standards in number of employees
511110	Newspaper Publishers		1,000
511120	Periodical Publishers		1,000
511130	Book Publishers		1,000
511140	Directory and Mailing List Publishers		1,250
511191	Greeting Card Publishers		1,500
512220	Integrated Record Production/Distribution		1,250
512230	Music Publishers		750
519130	Internet Publishing and Broadcasting and Web Search Portals		1,000
541711	Research and Development in Biotechnology <sup>11</sup>		<sup>11</sup> 1,000
541712	Research and Development in the Physical, Engineering, and Life Sciences (except Biotechnology) <sup>11</sup>		<sup>11</sup> 1,000
<i>Except,</i>	Aircraft, Aircraft Engine, and Engine Parts		1,500
<i>Except,</i>	Other Aircraft Parts and Auxiliary Equipment		1,250
<i>Except,</i>	Guided Missiles and Space Vehicles, Their Propulsion Units and Propulsion Parts.		1,250
562910	Remediation Services	\$20.5.0	
<i>Except,</i>	Environmental Remediation Services <sup>14</sup>		<sup>14</sup> 750

Footnotes

\* \* \* \* \*

11. NAICS code 541711 and 541712—

(a) “Research and Development” means laboratory or other physical research and development. It does not include economic, educational, engineering, operations, systems, or other nonphysical research; or computer programming, data processing, commercial and/or medical laboratory testing.

(b) For research and development contracts requiring the delivery of a manufactured product, the appropriate size standard is that of the manufacturing industry.

(c) For purposes of the Small Business Innovation Research (SBIR) program only, a different definition has been established by law. See § 121.701 of these regulations.

(d) “Research and Development” for guided missiles and space vehicles includes evaluations and simulation, and other services requiring thorough knowledge of complete missiles and spacecraft.

\* \* \* \* \*

14. NAICS 562910—Environmental Remediation Services:

(a) For SBA assistance as a small business concern in the industry of Environmental Remediation Services, other than for Government procurement, a concern must be engaged primarily in furnishing a range of services for the remediation of a contaminated environment to an acceptable condition including, but not limited to, preliminary assessment, site inspection, testing, remedial investigation, feasibility studies, remedial design, containment, remedial action, removal of contaminated materials, storage of contaminated materials and security and site closeouts. If one of such activities accounts for 50 percent or more of a concern’s total revenues, employees, or other related factors, the concern’s primary industry is that of the particular industry and not the Environmental Remediation Services Industry.

(b) For purposes of classifying a Government procurement as Environmental Remediation Services, the general purpose of the procurement must be to restore or directly support the restoration of a

contaminated environment (such as, preliminary assessment, site inspection, testing, remedial investigation, feasibility studies, remedial design, remediation services, containment, removal of contaminated materials, storage of contaminated materials or security and site closeouts), although the general purpose of the procurement need not necessarily include remedial actions. Also, the procurement must be composed of activities in three or more separate industries with separate NAICS codes or, in some instances (e.g., engineering), smaller sub-components of NAICS codes with separate, distinct size standards. These activities may include, but are not limited to, separate activities in industries such as: Heavy Construction; Specialty Trade Contractors; Engineering Services; Architectural Services; Management Consulting Services; Hazardous and Other Waste Collection; Remediation Services, Testing Laboratories; and Research and Development in the Physical, Engineering and Life Sciences. If any activity in the procurement can be identified with a separate NAICS code, or component of a code

with a separate distinct size standard, and that industry accounts for 50 percent or more of the value of the entire procurement, then the proper size standard is the one for that particular industry, and not the Environmental Remediation Service size standard.

\* \* \* \* \*

18. *NAICS code 541519*—An Information Technology Value Added Reseller (ITVAR) provides a total solution to information technology acquisitions by providing multi-vendor hardware and software along with significant value added services. Significant value added services consist of, but are not limited to, configuration consulting and design, systems integration, installation of multi-vendor computer equipment, customization of hardware or software, training, product technical support, maintenance, and end user support. For purposes of Government procurement, an information technology procurement classified under this exception and 150-employee size standard must consist of at least 15% and not more than 50% of value added services, as measured by the total contract price. In addition, the offeror must comply with the manufacturing performance requirements, or comply with the non-manufacturer rule by supplying the products of small business concerns, unless SBA has issued a class or contract specific waiver of the non-manufacturer rule. If the contract consists of less than 15% of value added services, then it must be classified under a NAICS manufacturing industry. If the contract consists of more than 50% of value added services, then it must be classified under the NAICS industry that best describes the predominate service of the procurement.

\* \* \* \* \*

■ 3. Amend § 121.406 by revising paragraph (b)(3) and paragraphs (b)(4) introductory text and (b)(5) introductory text to read as follows:

**§ 121.406 How does a small business concern qualify to provide manufactured products or other supply items under a small business set-aside, service-disabled veteran-owned small business set-aside, WOSB or EDWOSB set-aside, or 8(a) contract?**

\* \* \* \* \*

(b) \* \* \*

(3) The nonmanufacturer rule applies only to procurements that have been assigned a manufacturing or supply NAICS code, or the Information Technology Value Added Resellers (ITVAR) exception to NAICS code 541519. The nonmanufacturer rule does not apply to contracts that have been assigned a service (except for the ITVAR exception to NAICS code 541519), construction, or specialty trade construction NAICS code.

(4) The nonmanufacturer rule applies only to the supply component of a requirement classified as a manufacturing, supply, or ITVAR contract. If a requirement is classified as

a service contract, but also has a supply component, the nonmanufacturer rule does not apply to the supply component of the requirement.

\* \* \* \* \*

(5) The Administrator or designee may waive the requirement set forth in paragraph (b)(1)(iv) of this section under the following two circumstances:

\* \* \* \* \*

**Maria Contreras-Sweet,**

*Administrator.*

[FR Doc. 2016-00922 Filed 1-25-16; 8:45 am]

**BILLING CODE 8025-01-P**

## SMALL BUSINESS ADMINISTRATION

### 13 CFR Part 121

#### RIN 3245-AG50

#### Small Business Size Standards for Manufacturing

**AGENCY:** U.S. Small Business Administration.

**ACTION:** Final rule.

**SUMMARY:** The United States Small Business Administration (SBA) is increasing small business size standards for 209 industries in North American Industry Classification System (NAICS) Sector 31-33, Manufacturing. SBA is also modifying the size standard for NAICS 324110, Petroleum Refiners, by increasing the refining capacity component of the size standard to 200,000 barrels per calendar day for businesses that are primarily engaged in petroleum refining and by eliminating the requirement that 90 percent of the output to be delivered be refined by the successful bidder from either crude oil or bona fide feedstocks. The Agency is also updating Footnote 5 to NAICS 326211 to reflect the current Census Product Classification Codes 3262111 and 3262113. As part of its ongoing comprehensive size standards review, SBA evaluated employee based size standards for all 364 industries in NAICS Sector 31-33 to determine whether they should be retained or revised. This rule is one of a series of rules that result from SBA's review of size standards of industries grouped by NAICS Sector.

**DATES:** This rule is effective February 26, 2016.

**FOR FURTHER INFORMATION CONTACT:** Jorge Laboy-Bruno, Ph.D., Economist, Size Standards Division, (202) 205-6618 or [sizestandards@sba.gov](mailto:sizestandards@sba.gov).

**SUPPLEMENTARY INFORMATION:** To determine eligibility for Federal small business assistance programs, SBA

establishes small business size definitions (referred to as size standards) for private sector industries in the United States. The SBA's size standards generally use two primary measures of business size, average annual receipts and average number of employees. Financial assets, electric output, and refining capacity are used as size measures for a few specialized industries. In addition, SBA's Small Business Investment Company (SBIC), Certified Development Company (CDC/504) and 7(a) Loan Programs determine small business eligibility using either the industry based size standards or an alternative size standard based on both net worth and net income. At the start of the current comprehensive review of size standards, there were 41 different size standards, covering 1,141 NAICS industries and 18 "exceptions." in SBA's table of size standards. Of these, 31 were based on average annual receipts, seven on average number of employees, and three on other measures. Presently, there are 28 different size standards, covering 1047 NAICS industries and 16 "exceptions." Of these NAICS industries and exceptions, 533 are covered by size standards based on average annual receipts, 509 on average number of employees, and five on average assets.

Over the years, some members of the public have remarked that SBA's size standards have not kept up with changes in the economy, and in particular, that they do not reflect changes in the Federal contracting marketplace and industry structure. The last comprehensive size standards review was in the late 1970s and early 1980s. Size standards reviews since then, until this comprehensive review, were generally limited to a few specific industries in response to requests from the public and from Federal agencies. SBA also makes periodic inflation adjustments to its monetary based size standards. The latest inflation adjustment to size standards was effective July 14, 2015 (79 FR 33647 (June 12, 2014)).

Because of changes in industry structure and the Federal marketplace since the last overall review, current data no longer supported existing size standards for some industries. Accordingly, in 2007, SBA began a comprehensive review to determine whether existing size standards are consistent with current data, and to revise them, when necessary.

In addition, on September 27, 2010, the President of the United States signed the Small Business Jobs Act of 2010 (Jobs Act), 111 Public Law 240, 124 Stat. 2504, Sep. 27, 2010. The Jobs Act