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November 9, 2017

VIA EMAIL AND HAND DELIVERY

The Honorable John Boozman
United States Senate
141 Hart Senate Office Building
Washington, D.C. 20510

Re: Veteran-Owned Small Businesses Need More Support from VA

Dear Senator Boozman:

Our law firm is proud to represent small businesses owned by service-disabled veterans and veterans (referred to as “SDVOSBs” and “VOSBs”). We also serve as General Counsel for the National Veteran Small Business Coalition and our firm is spearheading the Coalition to Defend Vets First. In these roles, we have worked with many SDVOSBs and VOSBs that participate in the U.S. Department of Veterans Affairs’ (“VA”) Veterans First Contracting Program. Congress created this program through the Veterans Benefits, Health Care, and Information Technology Act of 2006. The Veterans First Contracting Program is designed to maximize the participation of SDVOSBs and VOSBs in VA acquisitions through contracting priorities that require VA to go “Vets First” in awarding its contracts.

The same policy judgments Congress made when it created the Veterans First Contracting Program – to care for and assist veterans in returning to private life and playing a greater role in our economy – hold true today. In fact, the veterans we talk to believe the Vets First mandate is needed now more than ever. Despite Congress’ creation of this important program over 10 years ago, VA’s prime contract spending on SDVOSBs and VOSBs has declined in recent years. So, too, has the number of small business prime contractors working with the federal government in general. And, subcontracting opportunities for SDVOSBs and VOSBs on VA contracts are nearly non-existent. In short, it is far from “mission accomplished” for the Veterans First Contracting Program.

We are enclosing a comprehensive white paper detailing many of the issues currently plaguing the Veterans First Contracting Program. This paper was prepared by concerned veterans to compile their experiences, contracting data, and legal arguments showing VA is not fully embracing the Vets First mandate – and in many respects is working against Congress’ intent. The enclosed white paper explains many of the problems SDVOSBs and VOSBs are currently encountering with VA, including:

- Declining prime contract spending and non-existent subcontracting for SDVOSBs and VOSBs, coupled with VA’s failure to set aggressive spending goals for SDVOSBs and VOSBs;

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- 96% of VA contracts below the simplified acquisition threshold in FY16 were not set-aside for SDVOSBs or VOSBs;
- Roughly three out of every four limited source justifications by VA result in non-competitive awards to large businesses;
- VA has adopted a policy that makes it more difficult than Congress intended for VA procurement officials to issue SDVOSB or VOSB sole source contracts;
- VA has issued many changes to its procurement regulations to limit the reach of the Vets First mandate through “class deviations” that are not subject to public notice and comment rulemaking; and
- VA is embarking on a massive new Medical Surgical Prime Vendor (“MSPV”) procurement, dubbed “MSPV 2.0,” that will increase annual spending on this program from \$1B to \$10B yet is planned to be consolidated into one contract that will effectively preclude prime contract participation by SDVOSBs and VOSBs.

The enclosed white paper paints a compelling picture that Congressional action is necessary to ensure VA meets its statutory obligations and fully embraces the Vets First mandate. And time is of the essence – each day that goes by, the policies and practices at VA that are contrary to Vets First become more entrenched, infect more procurement strategies (like MSPV 2.0), and harm more SDVOSBs and VOSBs.

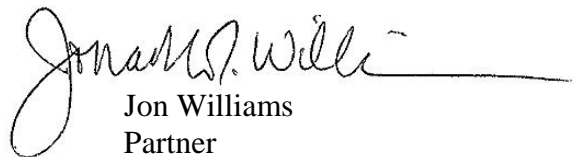
We would like your help to press VA for answers and meaningful changes. Ultimately, we believe a hearing is important and necessary to hold senior VA procurement personnel accountable and to get needed answers on what VA is doing to correct these issues. In the meantime, an unofficial roundtable discussion between your office, VA procurement personnel, and the veteran small business community would help to get these issues out in the open, allow both sides to share their views, and hopefully propel VA toward changes that will better fulfill the Congressional intent behind the Veterans First Contracting Program.

We will follow up with your office soon to discuss this matter further. Until then, we greatly appreciate your time and attention to this very important matter for the veteran small business community.

Sincerely,



John Shoraka
Managing Director
PilieroMazza Advisory Services



Jon Williams
Partner
PilieroMazza PLLC

Enclosure

Veteran Small Business Owners Need Congress' Help to Ensure the Department of Veterans Affairs Lives Up to the "Vets First" Mandate

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Overview

The importance of taking care of our military veterans has been well understood since the founding of our Nation. Indeed, George Washington famously observed that, "[t]he willingness with which our young people are likely to serve in any war, no matter how justified, shall be directly proportional to how they perceive veterans of earlier wars were treated by their nation." In recent years, Congress has rightly found that veterans "have been and continue to be vital to the small business enterprises of the United States."¹ However, Congress has also found that the U.S. Government "has done too little to assist veterans, particularly service-disabled veterans, in playing a greater role in the economy of the United States by forming and expanding small business enterprises."²

Small businesses owned by service-disabled veterans and veterans (referred to as "SDVOSBs" and "VOSBs") are, like all small businesses, critical to our economy and our industrial base. However, the current federal contracting climate is presenting a significant challenge for small business contractors. Federal spending data shows that consolidation of contracting opportunities across the federal government in recent years has led to a 25% reduction in the number of small business contractors performing on federal prime contracts since 2010.

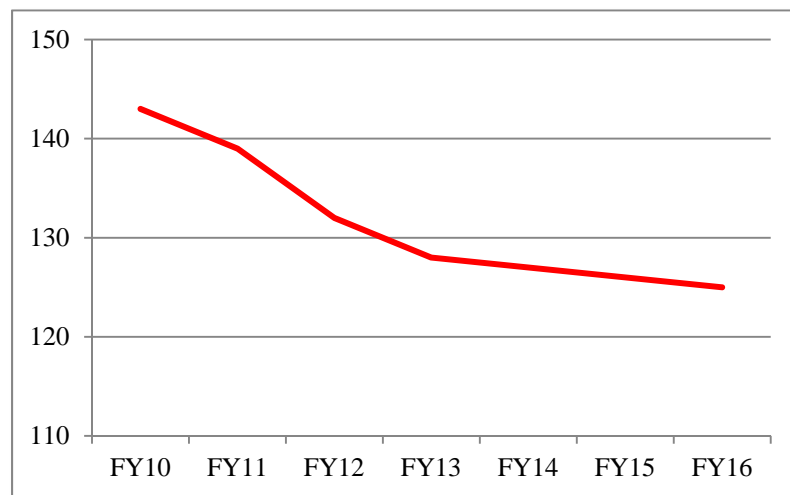


Figure 1 - Declining Small Business Primes (000s)

Source: Deltek

The U.S. Department of Veterans Affairs ("VA") has a unique role and obligation to grow the broader small business industrial base by assisting veteran small business owners in playing a greater role in our economy. In 2006, Congress passed the Veterans Benefits, Health Care, and Information Technology Act of 2006 ("VA Act") to create a special VA contracting program called the Veterans First Contracting Program.³ The aim of this program is to provide contracting priority for SDVOSBs and VOSBs in all VA acquisitions. In a nutshell, the Veterans First Contracting Program **"is a logical extension of VA's mission to care for and assist veterans in returning to private life."** It provides VA with the new contracting flexibilities to assist veterans in doing business with VA. SDVOSBs and VOSBs will obtain valuable experience through this VA program that can be useful in obtaining contracts and subcontracts with other government agencies as well."⁴

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Unfortunately, the Veterans First Contracting Program has not worked as well as Congress intended. Despite the statutory mandate and contracting program designed to give priority to SDVOSBs and then to VOSBs for VA prime contracts, VA's prime contract awards to SDVOSBs and VOSBs are in decline. Additionally, subcontracting to SDVOSBs and VOSBs on VA projects is almost nonexistent – and well below VA's modest goals. These trends persist despite the fact that VA has certified 12,519 firms as SDVOSBs and VOSBs eligible for VA contracting priority.

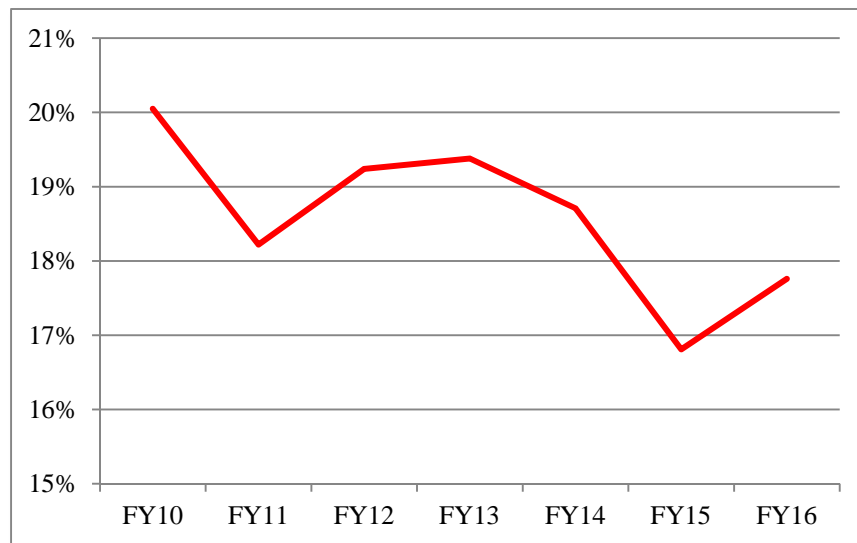


Figure 2 - Declining VA Prime Contract Spending on SDVOSBs

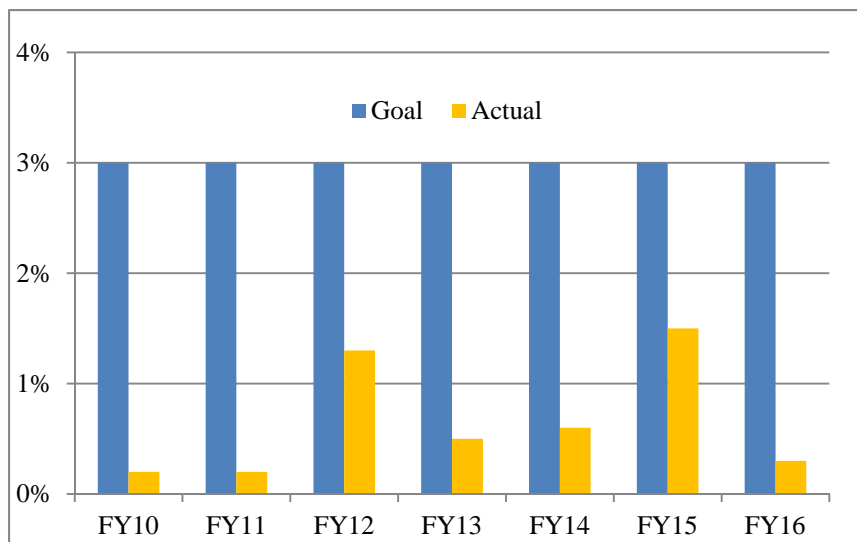


Figure 3 - VA SDVOSB Subcontracting Goals vs. Actual Subcontracting to SDVOSBs

Source for Figures 2 and 3: SBA Scorecards, available at <https://www.sba.gov/contracting/finding-government-customers/see-agency-small-business-scorecards>.

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If Congress gave VA the tools to foster a greater role in our economy for SDVOSBs and VOSBs, and VA has thousands of certified SDVOSBs and VOSBs at its disposal, why has VA failed to fulfill its mission? A big reason is that VA has not fully supported and adhered to the VA Act's "Vets First" mandate. Since the law's enactment, VA has fought numerous protests in which the agency advocated for a limited interpretation of the Vets First mandate.⁵ VA even took the extraordinary step (through an October 17, 2011 policy memo issued by VA's Deputy Assistant Secretary for Acquisition and Logistics) of ignoring recommendations of the U.S. Government Accountability Office ("GAO") in response to these protests.⁶ In one of the cases, brought by an SDVOSB named Kingdomware, VA fought against a broader interpretation of the Vets First mandate all the way to the U.S. Supreme Court – and lost.⁷

Many thought the Supreme Court's ruling in Kingdomware would serve as a needed "wake up call" for VA and would cause the agency to make a greater commitment to implementing the Vets First mandate. In Kingdomware, the Supreme Court unanimously ruled against VA and found that the Vets First mandate under the VA Act broadly applies to all VA contracts (including task orders). While VA said the right things in the immediate aftermath of the Supreme Court's ruling, the last year-and-a-half since the decision has seen VA return to business as usual. Unfortunately, business as usual for VA has meant not fully implementing the VA Act – and in many instances working against it.

The veteran small business community is now hearing rumors that some are advocating to repeal or amend the VA Act to limit the Vets First mandate because using SDVOSBs and VOSBs unnecessarily increases the cost for VA (and taxpayers). Such a rationale is dubious at best. Previous studies, including by the Congressional Budget Office, have found that contracting with small businesses does not significantly increase costs to the government.⁸ Further, the VA Act rightly requires SDVOSBs and VOSBs to submit reasonable prices. Congress appropriately determined that helping veterans as business owners, at a reasonable price, is a worthy objective and investment for our country and, specifically, for VA.

The purpose of this paper is to demonstrate how veteran business owners need Congress' help to ensure VA lives up to the Vets First mandate. In the first section, this paper provides details and supporting data on the ways in which VA is still not adhering to the VA Act. Sadly, the examples are many. In the second section, this paper details how VA, in the midst of its poor performance in following the Vets First mandate, is embarking on a massive, \$10 billion per year procurement for its controversial Medical Surgical Prime Vendor ("MSPV") 2.0 program. As currently constituted, the MSPV 2.0 procurement will end-run around the VA Act because the procurement is structured to effectively prevent SDVOSBs and VOSBs from participating in prime contracts for thousands of medical supplies that SDVOSBs and VOSBs can and routinely have provided to VA as prime contractors at fair and reasonable prices.

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Section I:

Examples of How VA Is Still Not Adhering to the Vets First Mandate

1. VA spending on SDVOSBs is in decline and VA is not aggressively establishing new spending goals

Based on the Vets First mandate and the Supreme Court's ruling that the law must be applied broadly to all VA contracts, VA's spending on SDVOSBs and VOSBs should be increasing. The number of certified SDVOSBs and VOSBs eligible for set-aside contracts has increased to 12,519 in November 2017. However, Figures 2 and 3 above demonstrate that VA spending on SDVOSBs is in decline. To make matters worse, VA is not aggressively establishing higher spending goals for SDVOSBs and VOSBs. For example, despite achieving nearly 18% spending on SDVOSBs in 2016, VA's goal for SDVOSB spending in 2017 is only 10%.

Solution: VA needs to establish more aggressive prime contract and subcontract spending goals for SDVOSBs and VOSBs, at least 25% for each category, prepare an action plan to overcome any barriers to meeting the goals, identify where they may need outside support, and regularly report to Congress on implementation of this action plan, their progress toward meeting the goals, and how they will hold senior VA procurement officials accountable if the new goals are not met.

Moreover, Figure 3 shows VA's performance at the subcontract level has been abysmal. Given VA spends the vast majority of its procurement dollars on large businesses each year, and those large businesses are required under the Federal Acquisition Regulation ("FAR") and the terms of their contracts to maximize utilization of SDVOSBs and VOSBs at the subcontract level, the subcontracting goals and enforcement process at VA is clearly broken.

Solution: Congress should require VA to report annually on its efforts to meet the subcontracting goals and its enforcement efforts, including the amount of liquidated damages VA collects from prime contractors that do not meet their SDVOSB and VOSB subcontracting goals.

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2. VA should be directing a much greater percentage of its smaller acquisitions to SDVOSBs and VOSBs

Some projects are so large and complex that they are not suitable for small businesses. However, smaller contracts are generally best suited for small businesses, especially those below the simplified acquisition threshold ("SAT"), which is currently \$150,000. In fact, the U.S. Small Business Administration ("SBA") regulations and the FAR require agencies to consider the "Rule of Two" and conduct a set-aside for small businesses on all contracts below the SAT.⁹

Despite the preference for small businesses to perform smaller acquisitions, as well as the greater suitability of this work for small firms, VA is failing to conduct any type of small business set aside for the vast

majority of its contracts below the SAT. As shown in Figure 4, FY16 contracting data obtained from VA through a Freedom of Information Act ("FOIA") request paints a stark picture on the lack of VA set-asides below the SAT. In FY16, VA conducted a total of 122,628 procurements valued at below the SAT. Of that total, 109,113 of the procurements – or a staggering 89% – were not set aside. And, only 5,314 of the procurements – or 4% – were set aside for SDVOSBs or VOSBs. Thus, at a time when VA's overall spending on SDVOSBs and VOSBs is declining, its performance in adhering to the Vets First mandate is far worse on smaller procurements many SDVOSBs and VOSBs would be best suited to perform.

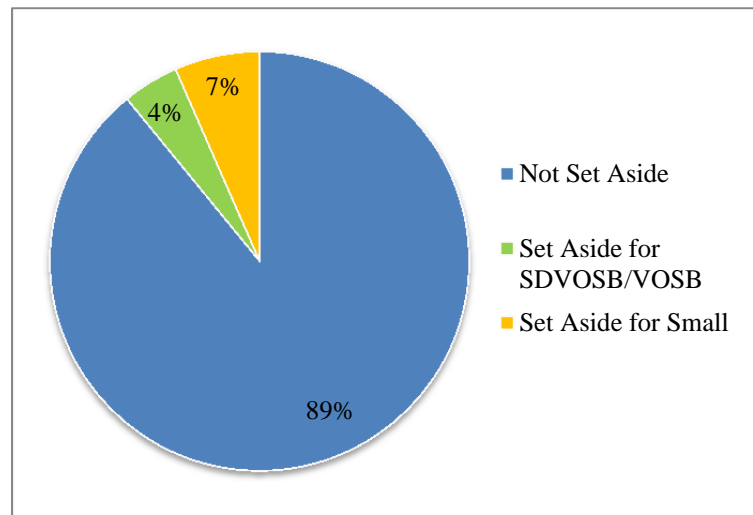


Figure 4 - VA Procurements Below the SAT in FY16

Solution: VA should issue new procurement guidance to confirm its procurement personnel must comply with the VA and Small Business Acts on contracts below the SAT. Also, Congress should require VA to report on its progress in maximizing participation of small businesses, especially SDVOSBs and VOSBs, on procurements below the SAT.

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3. VA is overusing limited source justifications (“LSJs”) to disproportionately award work to large businesses

When procuring supplies from a Federal Supply Schedule (“FSS”) contract, VA can use an LSJ to limit the source for an acquisition in extraordinary circumstances, such as for an urgent and compelling need or to avoid unacceptable delays.¹⁰ However, data on LSJs available from VA indicates it is overwhelmingly using LSJs to funnel work to large businesses, avoiding the Vets First mandate, and in many cases is misusing the LSJ authority.

VA data on the use of LSJs for MSPV formulary items shows that nearly three out of every four of these contracts go to large businesses.¹¹ And, only a small fraction – less than 10% – of the contracts with LSJs go to SDVOSBs and VOSBs. Thus, more than 9 out of every 10 LSJs used by VA for MSPV formulary items circumvent the Vets First mandate.

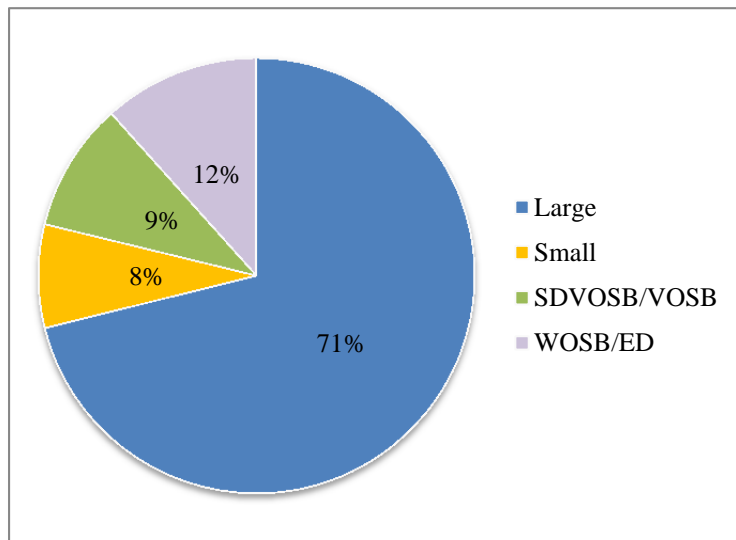


Figure 5 - LSJs for MSPV Formulary Items

Examining the individual LSJs for large businesses shows how VA is misusing this extraordinary contracting action to circumvent the VA Act. For example, on August 2, 2017, VA issued an LSJ for Solicitation No. VA11917Q0415. This LSJ is for a large business, Fisher Scientific Company, to provide disinfectant wipes. Comparable wipes are readily available from 44 small businesses, including 13 VOSBs and 11 SDVOSBs, through VA FSS SIN A-2B. And, it appears VA could have obtained a lower price – \$11 for a similar

canister, as opposed to \$16.08 for the Fisher Scientific canisters – if VA had done a competitive small business acquisition rather than justifying a single large business source.

Solution: VA should revise the LSJ process to give first priority in the use of LSJs to SDVOSBs and then VOSBs, consistent with Vets First. VA should also be transparent in its use of LSJs by reporting to Congress on the number of LSJs used each year for large businesses, SDVOSBs, and other types of small firms.

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4. VA has issued multiple policies that are contrary to the Vets First mandate

Since the Kingdomware decision, VA has enacted a series of practices and policies that seem designed to undercut the effect of the Supreme Court's ruling and the Vets First mandate. The examples below reflect new rules and policy memoranda that add substantial bureaucratic requirements to the statutory contracting assistance created by the VA Act. Rather than facilitate the statutory priority for SDVOSBs and VOSBs, these rules and policies have made it more difficult for VA to award contracts to SDVOSBs and VOSBs.

❖ VA Rules and Policies Improperly Limit Sole Source Contracts to SDVOSBs and VOSBs

The VA Act permits VA to make sole source awards to SDVOSBs and VOSBs when three conditions are met: (1) the concern is a responsible source; (2) the contract award price will exceed \$150,000 but will not exceed \$5 million; and (3) award can be made at a fair and reasonable price that offers best value to the United States.¹² Notably, this sole source authority granted in the VA Act does not require that the SDVOSB or VOSB awarded the contract is the only SDVOSB or VOSB that can provide the services or supplies at issue. Rather, the law merely requires that the SDVOSB or VOSB is a responsible source and award can be made at a fair and reasonable price – without a "Rule of Two" analysis. The law therefore shortens the VA procurement cycle, while increasing SDVOSB/VOSB opportunities.

Congress' will in creating the SDVOSB/VOSB sole source provisions in the VA Act is comparable to the sole source authority it granted to SBA's 8(a) program, yet VA has in practice negated Congress' intent. VA has done so by implementing regulations that limit the ability of VA contracting personnel to make sole source awards to SDVOSBs and VOSBs.¹³ Even though the VA Acquisition Regulation ("VAAR") 819.7007 states that a "determination that only one SDVOSB can meet the requirement is not required[.]" it also states that contracts awarded under this provision "shall be supported by a written justification and approval described in FAR 6.303 and 6.304, as applicable."¹⁴ FAR 6.304 provides that the contracting officer must receive the approval of the advocate for competition by the procuring activity designated pursuant to FAR 6.501, the head of the procuring activity, or the senior procurement executive of the agency prior to making award.¹⁵ Thus, for VA sole source awards to SDVOSBs and VOSBs, VA has decided a contracting officer must walk through many more bureaucratic steps than those provided in the VA Act for sole source authority. The additional regulatory requirements not found in the VA Act also take away the ability of VA contracting officers to award sole source SDVOSB and VOSB contracts by requiring approval at multiple levels above the contracting officer – unnecessarily delaying (if not preventing) SDVOSB/VOSB sole source procurements authorized by Congress.

Additionally, VA has implemented policies that create even more requirements beyond those in the VA Act and the VAAR. VA's Policy Memorandum 2016-05, issued on July 25, 2016, states that, if a contracting officer decides to make a sole source award as authorized by 38 U.S.C. § 8127(c), he or she "shall document this decision on VA Form 2268 and submit it with supporting documentation, as indicated in the OSDBU Small Business Procurement Review Program (PRP) Policy memorandum dated June 22, 2016." Pursuant to VA's June 22, 2016

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Small Business PRP Policy Memorandum, a Form 2268 must include: (i) Market research report and all supporting documentation (including copies of Sources Sought Notices and all responses); (ii) Acquisition Plan (if required); (iii) Statement of Work or other appropriate work description; and (iv) Independent Government Cost Estimate. These additional requirements – which are not mandated by 38 U.S.C. § 8127 – place more burdens on the contracting officer and make it significantly more difficult and time consuming to make a sole source award to an SDVOSB or VOSB.

Solution: Congress should direct VA to adhere to the sole source provisions of the VA Act and rescind all policies and regulations that make sole source awards to SDVOSBs and VOSBs more difficult to implement than Congress intended in the law. Congress should also require VA to report on its timeline for revising its sole source policies and rules and on its annual usage of the sole source authority under the VA Act.

❖ **VA's Rule Change Regarding Use of SBA's nonmanufacturer rule ("NMR") Violates Law and Regulations**

In February 2017, VA issued a class deviation that is contrary to SBA's NMR and has a significant adverse effect on SDVOSB and VOSB suppliers. SBA's NMR states that a small business may not provide products that it did not manufacture unless it meets certain conditions, including providing a product manufactured by a small business, or a waiver of the NMR is granted.¹⁶ If applicable requirements are met, SBA will waive the NMR for either a class of products or for a specific procurement.¹⁷

VA's February 17, 2017 class deviation was issued to add a VAAR provision that (i) requires the Head of Contracting Activities ("HCA") to approve any request by a VA contracting officer for a waiver of the NMR for individual procurements and, (ii) where SBA had issued a class waiver to the NMR, requires the contracting officer to receive approval from the HCA prior to utilizing other than competitive procedures or restricted competition as defined in 38 U.S.C. § 8217.¹⁸

Added without notice and comment rulemaking, this improper class deviation negatively impacts SDVOSB and VOSB suppliers for two reasons. With respect to waivers of the NMR for individual procurements, the authority to submit a request to SBA is vested with the contracting officer.¹⁹ By requiring a VA contracting officer to obtain the approval of the HCA before even making a request for an individual waiver of the NMR, VA has usurped a contracting officer's authority to request a waiver of the NMR and put that power in the hands of the HCA. This additional layer of bureaucracy places another unnecessary obstruction on VA awards to

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SDVOSBs and VOSBs and is contrary to the rules issued by SBA, the agency entrusted to make policy and regulations on small business issues.

With respect to class waivers of the NMR, this VAAR provision also requires HCA approval prior to using other than competitive procedures or restricted competition for a product for which SBA has issued a class waiver of the NMR. Practically, this means that, when VA is conducting its market research to determine if two or more SDVOSBs or VOSBs will submit offers for a supply procurement and there is an existing class waiver of the NMR for the supply, VA must obtain HCA approval to set the procurement aside for SDVOSBs or VOSBs. In effect, the HCA could withhold approval, and the procurement would not be set aside for SDVOSBs or VOSBs, even though the nonmanufacturer suppliers would qualify as "small" based on SBA's class waiver of the NMR. This outcome is contrary to the intent of SBA's NMR and the VA Act because it de-prioritizes awards to SDVOSBs and VOSBs and will result in fewer set-asides to such firms.

Solution: VA should rescind its class deviation on the NMR and follow SBA guidelines concerning the use of SDVOSB and VOSB set-asides with an NMR waiver.

❖ **VA is misusing statutory authority for prosthetics purchases to avoid competition amongst SDVOSBs and VOSBs**

Some VA procuring officials are relying on a prosthetics procurement statute, 38 U.S.C. § 8123, to conduct sole source procurements without competing the contracts among SDVOSBs or VOSBs. The prosthetics statute provides that VA may procure prosthetics without regard to any other law, which VA has determined includes the VA Act.²⁰ However, the prosthetics statute envisions VA would implement procedures for utilizing the broad purchasing authority under this law, and VA did just that via Veterans Health Administration ("VHA") Directive 1081. Directive 1081 states that, when using other than full competition to procure prosthetics, a VA contracting officer must exhaust the options under FAR sources for limited competition before using less than full and open competition under Section 8123.

Solution: VA needs to follow its own policy regarding use of the prosthetics statute. Additionally, VA's procuring officials should be considering competition and the Rule of Two for SDVOSBs and VOSBs even when making purchases under the prosthetics statute.

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❖ **VA's market research imposes unnecessary burdens on SDVOSBs and VOSBs**

When conducting market research, VA will often issue requests for information to gauge the interest of potential SDVOSB and VOSB offerors. While market research is itself a good thing, VA has in numerous instances required a significant amount of very detailed information from prospective offerors. In one instance, for a recent MSPV formulary procurement during the summer of 2017, VA conducted extensive market research, including requesting detailed information from prospective offerors, and then issued the solicitations. After receiving multiple protests of the solicitations, VA then cancelled the solicitations, and reissued an additional request for information seeking similarly burdensome amounts of information.

Given that all the prospective SDVOSB and VOSB offerors are small businesses, responding to multiple rounds of detailed requests for information can be cost prohibitive for prospective offerors – large and small. It is a major reason why Round 1 of the MSPV formulary distribution procurements only received a 30% industry response, according to VA's explanation in the LSJs for the formulary items. However, if few or no SDVOSBs or VOSBs respond to VA's market research, which is likely when the required response is too complicated or time-consuming, VA will conclude there are not a sufficient number of SDVOSBs and VOSBs and then will not set aside contracts for SDVOSBs and VOSBs. The VAAR directs VA to conduct market research by simply checking the VIP Database²¹ to determine if two or more SDVOSBs and VOSBs have the appropriate NAICS code – and then determine with just these firms whether they are capable of performing the work at a fair and reasonable price. This is a simple process that VA should keep simple. Also, when an FSS procurement is planned, VA can easily use their National Acquisition Center Contract Catalog Search Tool to check if an item is on an SDVOSB or VOSB FSS schedule.

Solution: VA should follow the simplified market research procedures in the VAAR and should avoid overly broad and detailed market research requests that are too burdensome for large and small businesses.

5. VA is improperly changing its procurement rules without following the requirements for public notice and comments

When an administrative agency intends to issue new regulations, it must publish a general notice of proposed rulemaking and give interested persons an opportunity to participate in the rulemaking process through the submission of written data, views, or arguments.²² As noted above, VA recently issued a class deviation to its procurement rules to significantly alter how it handles set-aside procurements involving waivers of the NMR. This class deviation is contrary to governing authorities of SBA, the agency that promulgated and enforces the NMR. VA may not have implemented this improper class deviation if it had first sought public comment, as it should, before making the rule. But, contrary to the required administrative procedures, VA simply added the new requirement without any public input.

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VA's class deviation on the NMR is just one example of this disturbing practice. Another example occurred on August 29, 2017, when VA issued "interim revisions" to the VAAR to incorporate changes made through "class deviations" that VA had previously issued without soliciting comments from the public.²³ These "class deviations" amended more than 14 provisions of the VAAR – all without publishing a notice of proposed rulemaking or giving the public an opportunity to participate. In fact, the class deviations are not embodied in the VAAR available from www.eCFR.gov or Westlaw; VA simply made the changes effective immediately through class deviations memos that remain in place until the VAAR is changed. VA should not be permitted to make such sweeping changes to its regulations without following the applicable administrative procedures for new rulemaking, especially when those changes have the effect of undermining Vets First.²⁴

Solution: Congress should hold VA procurement officials accountable for their issuance of rules without public notice or comment, direct VA to rescind such rules, and not issue any further rules without first going through public notice and comment.

6. VA is Not Applying Vets First Priorities and Preferences for SDVOSBs over VOSBs to Micro-Purchases

As another example of VA's use of class deviations, VA issued several changes to the VAAR last summer in response to the Kingdomware decision.²⁵ One of the changes was to implement a new policy to make clear that the Veterans First Contracting Program applies to simplified acquisitions under VAAR part 813. However, in practice, VA is not routinely adhering to this policy because it is not fully applying the VA Act to micro-purchases. The VA Act establishes a priority in the award of contracts to SDVOSBs, then VOSBs.²⁶ Both GAO and the Court of Federal Claims have confirmed the priority under the VA Act for SDVOSBs over VOSBs.²⁷ Yet, VAAR 813.202 (which would be VAAR 813.203 according to the July 2016 class deviation), states that "[o]pen market purchases shall be equitably distributed among all verified SDVOSBs or VOSBs to the maximum extent practicable in keeping with the flexibilities inherent under the micro-purchase threshold." The concept of "equitable distribution" is at odds with the VA Act, as it does not ensure SDVOSBs are given priority over VOSBs.

Solution: VA should revise VAAR 813.202/203 to make clear that "equitable distribution" occurs first among SDVOSBs and then to VOSBs as required by the VA Act.

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Section II: VA’s MSPV 2.0 Acquisition Strategy Is Fatally Flawed

The MSPV program is a national mandatory program for all VA medical centers (“VAMCs”). Under the program, all medical supplies that are available from MSPV prime vendor (“PV”) contractors must be ordered by VAMCs from the appropriate PV.

GAO has found many shortfalls in the original MSPV acquisition.²⁸ Orders under this \$465M a year program are not consistently entered in the VA electronic contract management system (“eCMS”) meaning VA is missing important information on its spending – including a lack of Vets First compliance.²⁹ All micro-purchase orders under MSPV are not recorded in the system.³⁰ GAO found that the data recorded in FPDS was \$10.4B higher than the same data in the VA eCMS.³¹ This limits VA knowledge and oversight of the current MSPV program spending.

With these flaws still in place, VA launched a new MSPV Next Generation (“MSPV-NG”) program, awarding \$4.6B in 2016 to four new PVs that combine to provide VAMCs with roughly \$1 billion in medical supplies each year. A fifth PV contract is planned. We understand a new GAO report on this MSPV-NG program will soon be released.

With MSPV-NG just started in 2016, VA has now embarked on a controversial new approach for the MSPV program, referred to as MSPV 2.0. **MSPV 2.0 is a massive undertaking.** The new program envisions the award of a single contract to provide supplies to 1,700 VA hospitals and clinics in support of 86.4 million patients per year. The objective of MSPV 2.0 is to provide VA a **“one-stop shop” with an overall goal of 95% usage.**³² In other words, a single MSPV prime contractor will supply 95% of the medical supplies required by VAMCs. This is a huge effort that would **increase annual MSPV spending to approximately \$10 billion with one firm.**

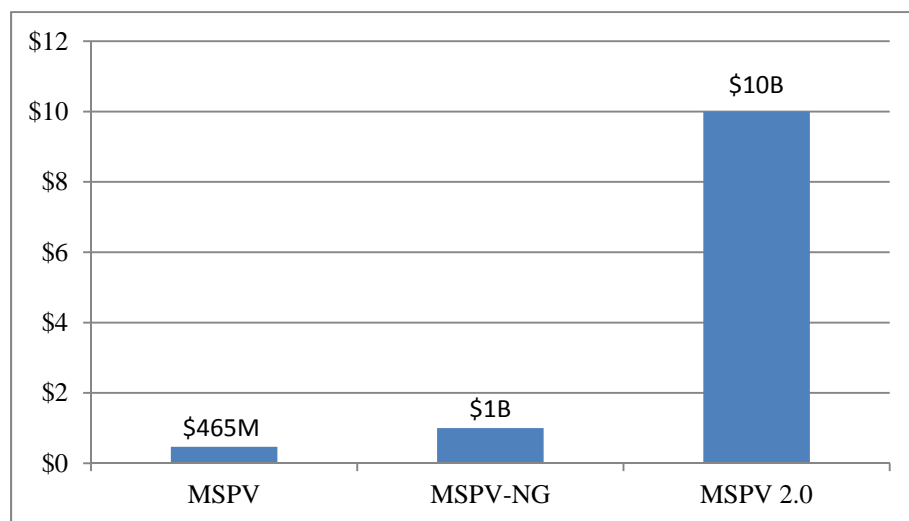


Figure 6 - Planned Increase in Annual MSPV Spending (in billions)

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VA is embarking on the massive MSPV 2.0 acquisition while it is also in the midst of several failed attempts at procuring the distribution contracts that will be utilized by the current MSPV-NG PVs in fulfilling VA's needs for formulary items. Most recently, VA faced 15 bid protests against its MSPV formulary distribution solicitations challenging, among other things, that the solicitations' cascading set-aside award methodology did not comply with the VA Act or provide any preference for SDVOSB suppliers as required by Vets First, and would improperly steer many of the contracts to large businesses. In response to the GAO protests, VA agreed to take voluntary corrective action. Yet, rather than remedying the errors alleged by the protestors, VA cancelled the procurements and then re-issued the solicitations without fixing many of the protested issues, and created new ones.

Returning to MSPV 2.0, **VA's goal of obtaining a "one-stop shop" will effectively eliminate ALL participation by small businesses at the prime contract level** and will make it very difficult to ensure or measure any small business participation in this massive program. In addition to providing thousands of medical supplies to 1,700 VA hospitals in support of 86.4 million patients, the single MSPV 2.0 prime contractor will also be responsible for providing strategic sourcing, life cycle management, distribution, inventory management and analysis services; quality control/quality assurance support services; and warranty management services for materials.³³ No small business can fulfill all of VA's MSPV 2.0 requirements. Indeed, given the scope of the requirements, only large businesses, such as Amazon, will be able to prime the MSPV 2.0 procurement. VA says it will ensure SDVOSB and VOSB participation at the subcontract level, but there are only "goals" at the subcontract level, not the Vets First mandate. And, as noted above, VA's SDVOSB performance at the subcontract level has consistently fallen well below even its modest goal of 3%.

The following discusses several of the flaws with MSPV in more detail and offers solutions to fix this procurement so it better reflects VA's mission to maximize participation of SDVOSBs and VOSBs in its acquisitions.

1. The MSPV-NG program is supported by a flawed VHA policy that is contrary to the VA Act and Kingdomware

Following the Kingdomware decision, on August 23, 2016, VHA issued a policy memorandum titled, "Mandatory Use of Prime Vendor Distribution Contracts and National Contracts."³⁴ The policy memo purports to alleviate the confusion caused by Kingdomware with respect to VA's use of MSPV contracts. While acknowledging that MSPV contracts are no longer mandatory sources as a result of Kingdomware, the policy memo states that VA will nevertheless continue to treat them as such. Thus, the true purpose of the memo is not to eliminate "confusion" caused by Kingdomware, but rather to make clear that VA will not follow the Supreme Court's ruling and apply the Vets First mandate to MSPV contracts.

Furthermore, the August 23, 2016 policy memo states that "[i]ndividual orders placed with prime vendors are not competitive contracting actions subject to the requirements of 38 U.S.C. 8127, commonly known in VA as [Vets First], including the application of the 'Rule

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of Two.”³⁵ This, too, is contrary to Kingdomware because the Supreme Court ruled that a task order is a contract subject to the VA Act and that law applies broadly to all VA procurements.

Solution: VA should rescind or revise the August 23, 2016 policy memo to make clear that the MSPV-NG prime vendor contracts are not mandatory and that task orders issued thereunder are, like all other VA contract actions, subject to the Vets First mandate.

2. MSPV 2.0 will completely end-run around Vets First and will not maximize participation by SDVOSBs and VOSBs

VA's new goal of a “one-stop shop” for MSPV 2.0 is contrary to law and will gravely harm SDVOSBs and VOSBs and other small businesses, in many respects.

First, combining all the PV contracts into one massive “one-stop shop” constitutes bundling of requirements that will violate the Small Business Act.³⁶ Before an agency can combine separate and multiple requirements – *i.e.*, “bundle” – it must properly coordinate the acquisition with SBA and, in doing so, demonstrate that the planned bundling will result in significant cost savings or operational efficiencies.³⁷ Here, it is unclear whether VA has properly coordinated with SBA regarding the planned consolidation/bundling. VA must do so before moving forward with the MSPV 2.0 procurement.

The medical supplies VA seeks to procure under MSPV 2.0 are currently being provided by 1,900 VA FSS contract holders at an annual cost of \$11 billion.³⁸ Of these FSS contracts, 1,479 (or 78%) are held by small businesses and 200 are held by SDVOSBs and VOSBs.³⁹ MSPV 2.0 plans to consolidate and bundle these contracts into a single requirement. VA seems to acknowledge that SDVOSBs and VOSBs cannot hope to compete to prime the “one-stop shop.” In this regard, one of VA's stated performance objectives for MSPV 2.0 is to “maximize SDVOSB and VOSB subcontracting opportunities.”⁴⁰ (Emphasis added.) Therefore, MSPV 2.0 is the very definition of improper bundling because it is combining work that small businesses can and do perform into one giant vehicle that no small business can do.

Additionally, VA's decision to involve SDVOSBs and VOSBs only at the subcontract level circumvents Vets First. Compared to prime contracts, subcontracts are not nearly as advantageous for SDVOSBs and VOSBs. Subcontractors face lower profit margins, lack privity of contract with the end customer, and do not gain any direct past performance with the federal government. Moreover, according to the August 23, 2016 policy memo discussed above, VA will not apply the Vets First mandate to orders under the MPSV contract. That means the MPSV 2.0 contract holder would not be required to reserve contracts for SDVOSBs or VOSBs.

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VA must do more to ensure SDVOSB and VOSB participation in the MSPV 2.0 procurement. If VA persists in treating orders under the MSPV 2.0 contract as subcontracts, it must provide definitive protections to ensure maximum participation by SDVOSBs and VOSBs at the subcontract level. Without significant "teeth" and oversight, there would be little ramifications if the MSPV 2.0 prime contractor does not meet its SDVOSB/VOSB subcontracting goals.

Solution 1: VA must consult with SBA to ensure the MSPV 2.0 contract is not improperly bundled to the detriment of small businesses.

Solution 2: VA must apply the Vets First mandate to orders placed under the MSPV 2.0 contract, consistent with Kingdomware, and VA should ensure the MSPV 2.0 contract holder(s) establish aggressive SDVOSB and VOSB subcontracting goals with penalties, including liquidated damages, for not meeting the goals and public reporting on their goal performance.

3. **VA's Office of Small Disadvantaged Business Utilization ("OSDBU") should be fighting harder for SDVOSBs and VOSBs against MSPV 2.0**

The mission of VA's OSDBU "is to enable Veterans to gain access to economic opportunity by leveraging the federal procurement system and expanding participation of procurement-ready small businesses."⁴¹ As such, with \$10 billion in annual contract work at risk of being taken from small businesses and placed into the hands of a single large business, VA's OSDBU should be pushing back hard against the planned MSPV 2.0 initiative. Indeed, as currently constituted, the MSPV 2.0 acquisition does not adhere to the Vets First mandate and contains no meaningful way to ensure maximum participation by SDVOSBs and VOSBs.

Unfortunately, VA's OSDBU appears to be a proponent of the current MSPV 2.0 initiative, **evidenced by the fact that the current Statement of Objectives for MSPV 2.0 was issued by VA's OSDBU.** In addition, VA's OSDBU posed a total of 96 questions for industry related to MSPV 2.0 – yet, none of the posted questions had anything to do with how industry might utilize SDVOSBs and VOSBs to provide the required medical supplies. If the veteran

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community cannot rely on VA's OSDBU to fight for SDVOSB and VOSB participation in the massive MSPV 2.0 procurement, Congress must take on the fight for them.

Solution 1: Congress should question the OSDBU's senior leadership on what they are doing to protect and maximize SDVOSB and VOSB participation in MSPV 2.0 – as well as why overall SDVOSB prime awards are declining and subcontract goals are not being enforced by OSDBU.

Solution 2: Congress should direct VA to comply with the Small Business and National Defense Authorization Acts' OSDBU requirements as outlined by GAO⁴² and place a group of its current 46 small business specialists under VA's OSDBU direct authority to oversee MSPV 2.0 and ensure there are sufficient "teeth," oversight, and accountability in the final MSPV 2.0 solicitation to ensure a significant level of participation by SDVOSBs and VOSBs.

4. MSPV 2.0 provides for the performance of a number of inherently governmental functions

Another flaw in VA's MSPV 2.0 strategy is that the planned procurement would result in the awardee performing inherently governmental functions. This is strictly prohibited by the FAR.⁴³ The FAR provides numerous examples of procurement functions that prime contractors cannot perform, such as "[d]etermining what supplies or services are to be acquired by the Government" and "awarding contracts."⁴⁴ According to the Office of Management and Budget ("OMB"), prohibited procurement functions also include "[e]xercising ultimate control over the acquisition, use, or disposition of United States property . . . including establishing policies or procedures for the collection, control, or disbursement of appropriated and other federal funds."⁴⁵ These are the same types of services that VA personnel are currently performing in support of the VHA supply chain management program, and they appear to be encompassed in VA's MSPV 2.0 acquisition strategy.⁴⁶ Specifically, under the planned MSPV 2.0 procurement, the prime contractor would perform extensive acquisition functions, including committing

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government funds, as well as establishing policies and procedures.⁴⁷ Such functions appear to violate the FAR's prohibition on contractors performing inherently governmental functions.

Solution: VA must remove inherently governmental functions from the MSPV 2.0 procurement and have OMB review the final acquisition strategy to ensure it does not require the prime vendor(s) to perform inherently governmental functions.⁴⁸

5. VA Financial Reporting on MSPV Spending Must be Improved

MSPV spending is not completely or accurately reported in eCMS, FPDS, or eSRS. The variances are likely in the hundreds of millions of dollars – if not higher. Until VA is able to ensure that it reports and has control over current MSPV spending in all three required systems (eCMS, FPDS, and eSRS), VA should focus its MSPV acquisition strategy on first solving these problems before further proposing or implementing a new MSPV 2.0 strategy. Until current MSPV spending is known, any new MSPV 2.0 strategy cannot be credibly evaluated.

Conclusion

This paper demonstrates that SDVOSBs and VOSBs need Congress' help to ensure VA lives up to the Vets First mandate. Despite clear statutory direction and the Supreme Court's unanimous ruling in Kingdomware, VA is still not fully adopting Vets First – and, in many cases, is actively working against the mandate. The VA Act is even more important now than it has ever been to reverse the decline in VA spending on SDVOSBs and VOSBs, maximize the participation of SDVOSBs and VOSBs in the massive MSPV 2.0 procurement, and continue to help our economy by growing the industrial base through veteran small business owners. In sum, we owe it to our veterans to take the steps outlined in this paper so VA will do more to ensure veteran business owners realize the full potential of the Veterans First Contracting Program.

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Endnotes

¹ 15 U.S.C. § 657b note, Veterans Entrepreneurship and Small Business Development Act of 1999, Pub. L. No. 106-50, § 101(3), 113 Stat. 233, 234 (1999).

² Id.

³ Pub. L. No. 109-461, §§ 502–03 (codified at 38 U.S.C. §§ 8127–28 (2006)); see also 48 C.F.R. § 819.7001.

⁴ Pub. L. No. 109-461, § 502, 120 Stat. 3403, 3431–32 (2006); see also VA Acquisition Regulation: Supporting Veteran-Owned and Service-Disabled Veteran-Owned Small Businesses, 74 FR 64619-01.

⁵ See, e.g., Powerhouse Design Architects & Eng'rs, B-403174, et seq. (Oct. 7, 2010) (GAO rejected VA's argument that procurements under the Brooks Act were not subject to the VA Act and its Vets First mandate); Angelica Textile Servs. v. United States, 95 Fed. Cl. 208 (2010) (the court rejected VA's attempt to contradict its own policy by ignoring the Vets First Contracting Program in favor of the AbilityOne program); Aldevra, B-405271; B-405524 (Oct. 11, 2011) (GAO rejected VA's interpretation that task orders under the FSS are not subject to the Veterans First Contracting Program).

⁶ The October 17, 2011 memo was issued to all VA acquisition personnel and stated that VA would not follow GAO's ruling in the Aldevra case because "VA is of the opinion GAO's interpretation [in Aldevra] is flawed and legally incorrect."

⁷ The Kingdomware case began as a protest to GAO, see Kingdomware Technology, B-405727 (Dec. 19, 2011), before winding its way through the court system all the way to the U.S. Supreme Court. See Kingdomware Techs., Inc. v. United States, 136 S. Ct. 1969, 195 L. Ed. 2d 334 (2016).

⁸ See CBO Cost Estimate for H.R. 4093 (May 2, 2014); see also American Society for Public Administration in the Public Administration Review, Vol. 54, No. 5 (finding no significant differences between bids submitted on set-aside competitions and bids submitted on unrestricted competitions).

⁹ 13 C.F.R. § 125.2(f)(1); 48 C.F.R. § 19.502-2(a).

¹⁰ 48 C.F.R. § 8.405-6(a).

¹¹ The MSPV formulary LSJ data is found in the current formulary item list available on VA's website at <https://www.va.gov/officeofacquisitionoperations/sac/mspvNG.asp>.

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¹² 38 U.S.C. § 8127(c).

¹³ VAAR 819.7007 sets out the requirements for a sole source SDVOSB award, while VAAR 819.7008 sets out the requirements for a sole source VOSB award.

¹⁴ VAAR 819.7007(c).

¹⁵ FAR 6.304(a)(2).

¹⁶ 13 C.F.R. § 121.406(b).

¹⁷ See 13 C.F.R. § 121.1204.

¹⁸ See VAAR 819.102(f)(4), (f)(5).

¹⁹ See 13 C.F.R. § 121.1204(b).

²⁰ See 38 U.S.C. § 8123.

²¹ See VAAR 810.002.

²² 5 U.S.C. §§ 553(b), (c).

²³ See VA Acquisition Update, Number 2008-03 (Aug. 29, 2017).

²⁴ Changes to the VAAR provisions about sole source awards to SDVOSBs and VOSBs and SBA's NMR, discussed further above, were implemented through these interim revisions to the VAAR without proper notice and comment rulemaking.

²⁵ See Class Deviation—Implementation of the Veterans First Contracting Program as a Result of the U.S. Supreme Court Decision (Class Deviation—Veterans First Contracting Program (VFCP 2016), issued July 25, 2016, available at https://www.va.gov/oal/docs/business/pps/deviationVCFP_20160725.pdf.

²⁶ See 38 U.S.C. § 8127(i) (stating that, in awarding contracts, VA must "give[] SDVOSBs priority over VOSBs."); see also VAAR 819.7004.

²⁷ See, e.g., Phoenix Environmental Design, Inc., B-407104 (Oct. 26, 2012) (confirming that 38 U.S.C. § 8127(i) "sets out an order of priority for the contracting preferences it establishes, providing that first priority for contracts awarded pursuant to 38 U.S.C. § 8127(d) shall be given to SDVOSB concerns, followed by VOSBs."); Powerhouse Design, supra; AmBuild Co. v. United States, 119 Fed. Cl. 10, 19 (2014) ("VA considers SDVOSB and VOSB entities as first and second priority for procurement awards.").

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²⁸ See U.S. Gov. Accountability Office, GAO-16-810, “Veterans Affairs Contracting: Improvements in Policies and Processes Could Yield Cost Savings and Efficiency” (Sept. 2016).

²⁹ Id. at p. 12.

³⁰ Id.

³¹ Id. at p. 13.

³² See Med Surg Prime Vendor (MSPV) 2.0 | Market Research | Web-based Questionnaire, Att. 2 at § 5.1.1.

³³ Id. at § 2.0.

³⁴ See U.S. Dep’t of Veterans Affairs, Policy Memorandum, “Mandatory Use of Prime Vendor Distribution Contracts and National Contracts” (Aug. 23, 2016).

³⁵ Id. at p. 1.

³⁶ See 15 U.S.C. §§ 632(o), 644(e).

³⁷ 48 C.F.R. §§ 7.107(a), 7.107-3; see also 2B Brokers et al., B-298651 (Nov. 27, 2006).

³⁸ U.S. Dep’t of Veterans Affairs, “VA Federal Supply Schedule Service,” available at <https://www.fss.va.gov/>.

³⁹ U.S. Dep’t of Veterans Affairs, National Acquisition Center, “SIN, Socioeconomic Status, Description Search: Socioeconomic Contract Listing – Small Businesses,” available at <https://www.va.gov/nac/Vendor/List?sid=2>.

⁴⁰ See Med Surg Prime Vendor (MSPV) 2.0 | Market Research | Web-based Questionnaire, Att. 2 at § 5.2.4.

⁴¹ U.S. Dep’t of Veterans Affairs, Office of Small and Disadvantaged Business Utilization, “About OSDBU,” available at <https://www.va.gov/osdbu/about/index.asp>.

⁴² See U.S. Gov. Accountability Office, GAO-17-675, “Small Business Contracting: Actions Needed to Demonstrate and Better Review Compliance with Select Requirements for Small Business Advocates” (Aug. 2017).

⁴³ See FAR 7.503(a).

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⁴⁴ See FAR 7.503(c)(12).

⁴⁵ OMB Circular No. A-76, "Performance of Commercial Activities" (May 29, 2003).

⁴⁶ See U.S. Dep't of Veterans Affairs, Veterans Health Administration, Directive 1761, "Supply Chain Inventory Management" (Oct. 24, 2016).

⁴⁷ See Med Surg Prime Vendor (MSPV) 2.0 | Market Research | Web-based Questionnaire, Att. 2 at §§ 5.3-5.4.

⁴⁸ See FAR 7.503(b).