HOUSE BILL REPORT
E2SHB 1096

As Amended by the Senate

Title: An act relating to enhancing small business participation in state purchasing.

Brief Description: Enhancing small business participation in state purchasing.

Sponsors: House Committee on General Government Appropriations (originally sponsored by Representatives Hasegawa, Green, Kenney, Chase, Hudgins and Moeller).

Brief History:

Committee Activity:

Community & Economic Development & Trade: 1/21/09, 2/4/09 [DPS];
General Government Appropriations: 1/26/10, 2/5/10 [DP2S].

Floor Activity:

Passed House: 2/13/10, 84-10.
Senate Amended.
Passed Senate: 3/11/10, 42-5.

Brief Summary of Engrossed Second Substitute Bill

- Applies a 5 percent bidding preference to in-state small business bidders with respect to goods and services purchased by the Department of General Administration, Information Services, and the Transportation for contracts awarded on or after November 1, 2010, but before July 1, 2014.
- Requires the GA to report to the Governor and Legislature each December 1, beginning with a preliminary report on December 1, 2010, on the small business bidding preference program.
- Expires the small business bidding preference program on December 31, 2014.

HOUSE COMMITTEE ON COMMUNITY & ECONOMIC DEVELOPMENT & TRADE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 8 members: Representatives Kenney, Chair; Maxwell, Vice Chair; Chase, Liias, Orcutt, Parker, Probst and Sullivan.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Minority Report: Do not pass. Signed by 1 member: Representative Smith, Ranking Minority Member.

Staff: Chris Cordes (786-7103).

HOUSE COMMITTEE ON GENERAL GOVERNMENT APPROPRIATIONS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass. Signed by 10 members: Representatives Darneille, Chair; Takko, Vice Chair; Blake, Dunshee, Hudgins, Kenney, Pedersen, Sells, Van De Wege and Williams.

Minority Report: Do not pass. Signed by 3 members: Representatives McCune, Ranking Minority Member; Klippert and Short.

Staff: Steve Smith (786-7178).

Background:

<u>State Procurement</u>.

The Department of General Administration (GA) establishes overall state policy for state purchasing, and contracts with individuals and companies outside of state government to provide goods and services to the state. Under delegated authority, other state agencies and the institutions of higher education also contract for goods and services. The state's purchasing authority is generally organized into categories based on the type of service. Among these categories are:

- *Purchased goods and services.* These goods and services are ones provided by a vendor to accomplish routine, continuing and necessary functions.
- *Personal services.* This term refers to professional or technical expertise provided by a consultant to accomplish a specific study or project.
- *Information services.* These services include data processing, telecommunications, office automation, and computerized information systems.
- *Printing services.* This term refers to the production of the state's printed materials.

Except in specific circumstances, Washington law does not provide preferences to bidders who are in-state. The statutory exceptions include:

- *Ferries.* In Washington, the Department of Transportation's bid documents for jumbo ferries must include a requirement that the vessels be constructed within Washington, with exceptions for certain equipment and systems.
- *Washington-grown food for schools.* School districts are authorized to implement policies to maximize the purchases of Washington-grown food. Such policies may include permitting a percentage price preference for Washington-grown food.
- *In-state printing.* Printing for state agencies must be done within Washington, unless the work cannot be executed in state or the lowest in-state bid exceeds the customary charges in the private sector.

In addition to these in-state preferences, the GA is required to identify other states that provide in-state preferences to their own bidders. If a bidder from one of those states submits a bid for a state contract in Washington, the GA may add a percentage increase to that bidder's proposal. This increase is used only to evaluate the bid and is not paid to any supplier whose bid is accepted.

<u>Legal Challenges to In-state Preference Laws</u>.

State procurement laws that give preference to domestic goods or prohibit purchasing foreign goods have been challenged on one or more grounds. These include arguments that such laws are: (1) invalid exercises of state power under the federal Commerce Clause; (2) preempted by federal statute or in violation of international agreements on government procurement; or (3) in violation of Equal Protection/Privileges and Immunities clauses.

Commerce Clause. The U.S. Constitution reserves to Congress the power to regulate commerce. The U.S. Supreme Court has struck down state laws that regulate commerce in a manner that promotes businesses in the state at the expense of businesses in other states or foreign countries. However, the U.S. Supreme Court has also recognized that, when a state acts as a market participant, rather than a market regulator, it is not subject to the restraints of the Commerce Clause. For example, other federal and state courts, relying on the "market participant doctrine," have generally upheld state "Buy American" laws.

Federal Preemption. The U.S. Supreme Court has found that state laws in conflict with valid federal laws, including statutes, treaties, or foreign policies and diplomatic objectives of the President and the Congress are preempted. For example, states may receive federal funding with conditions that include prohibitions on local bidding preferences.

Trade agreements may also raise a barrier to local preferences. The Agreement on Government Procurement (GPA) is one of many World Trade Organization agreements to which the United States is a party, and is one of several agreements that apply to Washington and certain other states. In Washington, state agencies subject to the GPA include certain executive branch agencies such as the GA and the Department of Transportation, as well as the state institutions of higher education. For the calendar years of 2010-2011, state contracts subject to the GPA currently include contracts of $554,000 or more for goods and services, and contracts of $7,804,000 or more for construction services.

Article III of the GPA, dealing with national treatment and non-discrimination, provides that:
- Parties to the agreement must treat the products, services, and suppliers of other parties no less favorably than domestic products, services, and suppliers.
- Parties must not treat locally-established suppliers less favorably than other suppliers on the basis of foreign affiliation or ownership.
- Parties must not discriminate against locally-established suppliers on the basis of the country of production of the good or service being supplied.

Equal Protection/Privileges and Immunities. In general, courts may require states to justify a local preference law as rationally related to a legitimate state interest. At least one court has found that the state has a legitimate interest in ensuring that tax monies are recycled through the local economy through the purchase of locally produced products or purchases from local vendors.

Other States' In-state Preference Laws.

Several other states, including Alaska, Hawaii, Louisiana, Montana, New Mexico, New York, South Carolina, and Wyoming, have government procurement bidding preferences for in-state bidders or products. Arizona and California have a bidding preference for in-state small businesses.

Summary of Engrossed Second Substitute Bill:

To the extent consistent with international trade agreement commitments and federal law, three purchasing agencies, the GA and the departments of Information Services and Transportation, must apply specified small business bidding preferences in awarding goods and services contracts, including contracts for personal services and for electronic data processing equipment, for the use of the respective agency. The small business bidding preference program applies to contracts awarded on or after November 1, 2010, but before July 1, 2014. It includes the following preferences:

- a 5 percent preference for small business bidders; and
- up to a 5 percent preference, as determined by purchasing agency rules, for other Washington bidders that provide for small business participation in the contract.

A purchasing agency may suspend the required bidding preference for purchases made through a multi-state contracting consortium unless the contracting is done for the purpose of avoiding the preference requirement.

The purchasing agencies must assist small businesses by:

- providing technical assistance to mitigate experience barriers related to a contract;
- allowing alternative methods to meet any inventory level requirements related to a contract; and
- assisting with qualification applications required for bidding.

"Small business" is defined as either (1) a business certified by the Office of Minority and Women's Business Enterprises, or (2) a Washington business with 50 or fewer employees, or $7 million or less in average annual gross revenues, that certifies under penalty of perjury its qualifications as a small business.

Businesses that obtain a bidding preference based on false information are subject to the following penalties:

- a civil penalty of 10 percent of the contract or $1,000, whichever is less, plus the difference in the state's contract cost if it had been properly awarded;
- if false information is given or information concealed with intent to defraud, an additional civil penalty of 10 percent of the contract or $10,000, whichever is greater; and
- ineligibility for state contracts for six months to three years, as determined under purchasing agency criteria.

Any civil penalties collected must be deposited in the newly created Small Business Bidding Preference Account, a nonappropriated account from which the purchasing agencies may request funding to use toward defraying the costs of adjudications under the small business bidding preference program.

The purchasing agencies, in consultation with each other, must adopt rules to implement the bidding preference requirements. The small business bidding preference program expires December 31, 2014.

EFFECT OF SENATE AMENDMENT(S):

The Senate amendment deletes the small business bidding preference pilot project and replaces it with direction to the three purchasing agencies to develop a plan for increasing the number of small businesses receiving state contracts for goods and services. The plan's goal is to increase small business participation by 50 percent by 2012 and by 100 percent by 2014, compared to 2009. This plan requirement expires July 1, 2015.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony (Community & Economic Development & Trade):

(In support) Small business owners, especially minority and women-owned businesses, feel like they do not have access to state contracting. Small businesses are the backbone of the state's economy. If given a chance, they will help the state rebound from the recession. The challenge is the fiscal impact. The main concern is the administrative cost of the program. However, the federal contracting program shows that self-identification of small businesses is a workable administrative solution when there are consequences for lying about business size. The other fiscal concern, the higher costs of contracts, is mitigated by the fact that the money will get re-circulated in Washington. The cost may be offset by the potential multiplier effect. This type of program also increases competition as more firms can bid. The federal program also shows that firms tend to move up the ladder to larger projects as they gain experience. Some programs set aside contracts under a certain amount for small businesses. California has had a small bidder preference for many years. As a result, many small California companies have gotten experience that enables them now to bid in Washington.

(With concerns) The Departments of General Administration and Information Services share a common interest with the Committee in addressing the concerns of small businesses and understand the need to level the playing field and bring them into the system. However, implementing the bill will require a registry for small businesses and enforcement mechanisms, with rules, policies, procedures, extra staff, training of staff, etc. There would also be a contract cost if contracts go to the small business based on the effect of the 7 percent preference. This could result in a significant increase in the cost of contracting for the same goods and services.

(Opposed) None.

Staff Summary of Public Testimony (General Government Appropriations):

(In support) As the bill came out of the Community, Economic Development and Trade Committee, the fiscal note (FN) concerned the Community, Economic Development, and Trade Committee, and it was the intent to narrow the bill down to a pilot program for the GA to see how it could be implemented. Small businesses know who they are and participation in the GA's contracts would be largely a self-policing system before considering the penalties in the bill that would further prevent fraud on the part of businesses. The GA portion of the FN has State General Fund costs of $29,000, which are relatively low given the multiplier effect in savings generated by the employment from these contracts. Ninety-eight percent of the businesses in the state are small businesses, and favoring contracts with small Washington businesses helps foster the Washington economy. The program is well worth it, and the program will help increase local hiring and keep money in the community. By contrast, sending jobs outside the state does not have these multiplier effects and does not contribute to the state. Other states have similar bidding preferences for in-state bidders, such as Alaska, Hawaii, Louisiana, Montana, New Mexico, New York, South Carolina, and Wyoming, while Arizona and California have small business preferences. The bill has bipartisan support and it only had one vote against in the policy committee. In a survey Tabor 100 conducted, it was determined that these kinds of bills need to be champions. There are barriers to small business in state contracts and not enough will to remove them. Small businesses comprise over 90 percent of all businesses in the state and we need to support them. Large businesses have the advantages of economies of scale and are better able to participate in state bidding pressure which ends up undercutting small businesses. There are discrepancies between state agencies in the way that contracts are awarded. There are many impediments to small businesses in terms of needed certifications, relationships with certain product lines or the transfer of risk from government to small businesses. This bill supports small businesses in Washington. Small businesses are the backbone of the Washington economy, and this bill helps to remedy the imbalance of procurement to small, in-state businesses, but also helps larger in-state businesses as well. In this time of economic dislocation, this bill helps keep jobs in Washington. This bill protects small businesses, which are becoming an endangered species. State contracts are becoming more difficult to obtain, and by not helping small businesses out, the state becomes more vulnerable to the "big box" mentality. The bill is in the best interest of the state economically in the long term. In the long term, small businesses become the state's large businesses. Small business is also part of large business and helps add diversity to the mix and sustain the economy in difficult times. Low bids, which often come from larger options, are also not always the best option for value reasons, and the added value that comes from small businesses should be acknowledged. Also, minority-owned businesses are usually small businesses, and the state has a bad record of facilitating relationships with minority-owned businesses: a problem the state should strive to remedy. Similar communities assist their small businesses and Washington should follow their examples. Small businesses have the hurdles of bureaucracy, paperwork, and the cost of responding, and these impediments really accumulate. The Federal Reserve of Atlanta looked at the sources of unemployment in this economic cycle that have come from firms with 50 or fewer people. In the 2001 economic cycle, that number was 9 percent, and this is important because coming out of recessions, these same businesses represent about 33 percent of the job growth. Proposed second substitute house bill 1096 is a calling card for all of the prospects from other states. This is an opportunity for us to address how best to help small businesses. There are costs such as the cost to bid and the costs of training, and any incentives to compete on a level playing field would help. California has a small business certification and eligibility process and incorporates a 5 percent preference for small businesses. A significant number of small businesses that fall under an even smaller threshold: for example, 93 percent of businesses in Washington meet the definition of a small business and employ fewer than 20 employees, are operated by the owner, and earn less than $3 million in gross annual revenue. Businesses affiliated with the Office of Minority and Women's Business Enterprises are also having a hard time with state contracts. Twenty five years ago, the Legislature found that in-state preference clauses in other states had a discriminatory effect on Washington vendors, and the Legislature should take measures to address this. Three statutes have empowered the GA to counteract these practices to help local, in-state businesses to be able to bid competitively.

(With concerns) The GA develops about 300 master contracts that agencies use on a regular basis. The GA is a strong supporter of small businesses, and supported P2SHB 1095 and SSB 5723 (Chapter 486, Laws of 2009), and the GA is striving to improve. The GA's two concerns with this bill are: (1) the bill could increase costs as much as 7 percent, and state agencies, then, could elect under the best buy provision, not to use the GA contracts. Similarly, cities and colleges could also elect not to use these contracts; and (2) self-certification and protests are an issue because if a vendor's eligibility of a vendor is questioned, it is unclear how the GA could support the administrative defense of these accusations. There would also be a burden of policing small agencies. The GA would request that the definition of small business align with the definition in chapter 486, Laws of 2009, and also they point out that the bill does not address construction services.

(Opposed) None.

Persons Testifying (Community & Economic Development & Trade): (In support) Representative Hasegawa, prime sponsor; and Erin Nielsen.

(With concerns) Howard Cox and Sharon Case, Department of General Administration; Tamara Jones, Department of Information Services; and Dan Swisher, Office of the Public Printer.

Persons Testifying (General Government Appropriations): (In support) Representative Hasegawa, prime sponsor; Richard Mitchell, Tabor 100; Edward Jones, Best CCLS, Inc; Ali Raad, Raad Properties Co.; Robert E. Smith, Womer and Associates; Glenn Gregory, Coalition for Investing in Washington Jobs; Silas Potter; and Ralph Ibarra, Diverse America Network.

(With concerns) Steve Krueger, Department of General Administration.

Persons Signed In To Testify But Not Testifying (Community & Economic Development & Trade): None.

Persons Signed In To Testify But Not Testifying (General Government Appropriations): None.