

HOUSE BILL REPORT

HB 1096

As Reported by House Committee On:
Community & Economic Development & Trade

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

Brief Description: Enhancing small business participation in state purchasing.

Sponsors: Representatives Hasegawa, Green, Kenney, Chase, Hudgins and Moeller.

Brief History:

Committee Activity:

Community & Economic Development & Trade: 1/21/09, 2/4/09 [DPS].

Brief Summary of Substitute Bill

- Requires the Department of General Administration (GA) to apply a 7 percent bidding preference to small business bidders with respect to the GA's goods and services contracts awarded on or after November 1, 2009, but before July 1, 2013.
- Requires the GA to report to the Governor and Legislature each December 1, beginning with a preliminary report on December 1, 2009, on the small business bidding preference program.
- Expires the small business bidding preference program on December 31, 2013.

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.

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

Staff: Chris Cordes (786-7103)

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.

Background:

State Procurement.

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.

Legal Challenges to In-state Preference Laws.

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 (WTO) 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 2008-2009, state contracts subject to the GPA currently include contracts of \$529,000 or more for goods and services, and contracts of \$7,456,000 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 Substitute Bill:

To the extent consistent with international trade agreement commitments, the GA must apply specified small business bidding preferences in awarding goods and services contracts, including contracts for personal services and for electronic data processing equipment. The preference program applies to the GA contracts awarded on or after November 1, 2009, but before July 1, 2013. It includes the following preferences:

- a 7 percent preference for small business bidders; and
- up to a 7 percent preference, as determined by the GA, for other Washington bidders that provide for small business participation in the contract.

The GA 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 a Washington business with 50 or fewer employees, and \$10 million or less in average annual gross revenues. The business must be performing a commercially useful function and must not be dominant in its field of operation. The business must certify, 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:

- 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 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 by the GA.

The GA must adopt rules to implement the bidding preference requirements. The small business bidding preference program expires December 31, 2013.

Substitute Bill Compared to Original Bill:

The substitute bill: (1) limits the small business bidding preference program to the GA's goods and services contracts awarded on or after November 1, 2009, but before July 1, 2013; (2) adds to the definition of a small business by requiring the business to certify, under penalty of perjury, its qualifications as a small business; (3) requires the GA to report on the small business bidding preference program to the Governor and Legislature each December, beginning with a preliminary report on December 1, 2009; and (4) expires the small business bidding preference program on December 31, 2013.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on February 4, 2009.

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

Staff Summary of Public Testimony:

(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.

Persons Testifying: (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 Signed In To Testify But Not Testifying: None.