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Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515-6315

November 10, 2014

VIA E-MAIL

Dr. Khem R. Sharma, Ph.D.
Chief, Size Standards Division
United States Small Business Administration
409 Third Street, S.W., Mail Code 6530
Washington, DC 20416

RE: Small Business Size Standards; Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, 79 Fed. Reg. 53,646 (September 10, 2014)

Dear Dr. Sharma:

On September 10, 2014, the Small Business Administration (SBA) proposed regulations to modify the size standards for 30 industries and three sub-industries that have employee-based size standards. 79 Fed. Reg. 53,646 (2014) (Proposed Rule). The Proposed Rule was issued to comply with the Small Business Jobs Act of 2010 (Jobs Act), which requires that the SBA conduct a detailed review of all size standards and make appropriate adjustments to reflect market conditions every five years.[1] While the Committee applauds the agency for complying with the Jobs Act, the Committee notes that the Proposed Rule violates the express statutory language added to the Small Business Act (the Act) by the National Defense Authorization Act for Fiscal Year 2013 (FY 13 NDAA).[2] Furthermore, the provisions in the Proposed Rule concerning the Information Technology Value Added Reseller (ITVAR) size standard fail to address the underlying issues facing the information technology (IT) industry and the misuse of the size standards. Therefore, for the reasons detailed in the rest of the comment letter, the Committee urges the agency to withdraw the proposed rule.

Modifications to SBA size standards have significant implications for SBA programs, federal procurement opportunities for small businesses, the Regulatory Flexibility Act, Executive Order No. 12,866, and federal regulatory programs in which the term "small business" is used. The

1 Pub. L. No. 111–240 § 1344, 124 STAT. 2504, 2545 (Sept. 27, 2010).
2 Pub. L. No. 112–239 § 1661, 126 STAT. 1632, 2083 (Jan. 2, 2013).

Committee is highly troubled by the Proposed Rule for legal and policy reasons. The Committee finds that the Proposed Rule failed to follow the express language of the Act for the reasons detailed in this comment letter. As such, the Committee directs the SBA to undertake a rulemaking that is legally sufficient, withstands judicial scrutiny, and does not tempt Congress to take appropriate ameliorative action.

I. The Small Business Act – Statutory, Regulatory, and Legislative Background to the Proposed Rule

In order to fully understand the Committee's concerns, it is first necessary to place the size standard process in context. This begins with an explanation of the law prior to the most recent changes in 2013, followed by an explanation of how the SBA exercised its authority prior to 2013, and a discussion of the legislative changes made in 2013.

a. Statutory Requirements Prior to 2013

Section 3(a)(1) of the Small Business Act, 15 U.S.C. § 632(a)(1), provides, in pertinent part:

> [a] small business concern ... shall be deemed to be one that is independently owned and operated and which is not dominant in its field of operation.

The Act does not define the terms "independently owned and operated" or "dominant in its field of operation." Instead, the Administrator is authorized to:

> specify detailed definitions or standards by which a business concern may be determined to be small for purposes of this Act or *any other Act*.

15 U.S.C. § 632(a)(2)(A).

The Administrator is authorized to consider number of employees, dollar volume of business,[3] net worth,[4] net income, other factors, or any combination of those factors. In short, Congress has granted the Administrator substantial discretion in the factors that will be utilized in calculating the size of a small business.

Until 2013, the SBA's discretion was principally tempered by the fact that any size standard determined by the factors set forth in § 3(a)(2) of the Small Business Act must meet the

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3 Current SBA size standards use gross revenue as a measure of dollar volume. Nothing in the Act requires reliance on dollar volume and other measures could be used.

4 The net worth standard is used, for among other purposes, to determine eligibility for investments made by small business investment companies, loans made pursuant to Title V of the Small Business Investment Act of 1958, and for participation in the program established by § 8(a) of the Small Business Act.

overarching principle – the business must be independently owned and operated and not dominant in its field. Historically, the SBA utilized two distinct standards for determining whether a business was dominant in its field. Manufacturers, distributors, and certain utilities were measured by the number of employees. All other businesses, both services and retail establishments, were calculated by the gross revenue of the firm. The two standards never overlapped. If the SBA determined that a particular industry was measured by gross revenue, the SBA also did not also impose an employee threshold. Thus, the SBA created a bright line standard in which a business either was required to enumerate employees or tabulate gross revenue. However, in 2003, the SBA proposed to modify all of its small business size standards by converting them all to employee-based standards.[5] As a result of strong criticism of the rule, the SBA withdrew the proposal on July 1, 2004, and began the process that led to the development of its current size standard methodology.

b. Size Standard Methodology

SBA formalized its process for establishing size standards when it published a white paper entitled "Size Standards Methodology"(methodology) detailing the five primary industry factors considered when establishing size standards.[6] An in-depth explanation of the current process would be quite lengthy, so this memorandum attempts to summarize the process. However, the full methodology is available at www.sba.gov/size.

The five factor analysis begins by examining four economic characteristics of the industry: average firm size, start up costs and entry barriers, industry competition, and distribution of firms by size (13 CFR § 121.102(a)). Additionally, the SBA's fifth factor examines the impact of an existing size standard as well as the potential impact of a size standard revision on the SBA's Federal contract assistance to small businesses. After considering the primary evaluation factors, the SBA will then assess any industry specific factors, such as technological changes and industry growth trends. This methodology supports the Committee's longstanding view of how size-standards should be developed: granular analysis of specific industry characteristics.

Data for this analysis is drawn from the Economic Census, and County Business Patterns, each published by the U.S. Census Bureau, as well as the U.S. Bureau of Labor Statistics' Quarterly Census of Employment and Wages and Business Employment Dynamics, the Risk Management Association's Annual Statement Studies, the Federal Procurement Data System, and SBA's own lending data. After the analysis is complete, the SBA then proposes what it believes to be the correct size standard. Final size standards are selected after input from the public through notice and comment rulemaking.

While the Committee generally approved of the methodology, two issues arose in 2011 that suggested that the SBA's application of the methodology was prioritizing administrative ease over precision when developing the size standards. Previously, there were roughly 1100 industrial classifications aligned with the North American Industrial Classification System (NAICS) codes for which the SBA previously had 41 size separate size standards. These standards were based on either the number of

5 Small Business Size Standards; Restructuring of Size Standards. 69 Fed. Reg. 13,130 (2004)
6 Size Standards Methodology, 74 Fed. Reg. 53940 (October 21, 2009).

employees, gross revenue, or other factors[7] that the SBA believes reflect the correct size of the business. However, in the name of simplification, SBA proposed selecting future size standards from a limited number of fixed size standards: eight revenue based standards and eight employee-based standards.[8]

However, the methodology also posits that where industries are closely related, SBA will consider a common size standard, even if the underlying analysis would otherwise support different size standards. This will most often occur when many of the same businesses operate in the same two or more industries, so SBA believes that the common size standard will better reflect the industry marketplace. As an example, as part of a 2011 proposed rule, SBA suggested a common size standard for the Computer Systems Design and Related Services industries (NAICS 541511-541519), because firms engaged in IT related services typically perform activities in two or more other related industries.[9] The proposed shift to fewer, consolidated size standards drew congressional attention.

c. Legislative Changes of 2013

SBA's 2011 proposal to artificially limit the number of size standards and to consolidate related industries into single size standards led to an outcry from industry, particularly in those cases where even when the SBA's own methodology indicated that different size standards were most appropriate.[10] As an example, the SBA proposed consolidating architectural firms and engineering firms into a single size standard, based on the premise that:

> It is very likely that firms that have expertise in architectural, engineering and surveying activities are also likely to be capable of performing drafting work. Similarly, general architectural firms are very likely to have expertise in landscape architectural services. Industry data also show a lot of similarities among architectural, landscape architectural, engineering, drafting and surveying industries.[11]

However, industry was quick to highlight that while a small engineering firm may have some drafting capabilities, the combined size standard would wreak havoc on small architectural firms. At the time of the proposal over 91 percent of architectural firms were considered small, and the consolidated size standard would have more than tripled the then-size standard of $4.5 million, rendering all but a few behemoth firms as small businesses.[12] In response to comments, the SBA maintained the separate size standards for architects and engineers, but it continued to implement common size standards for other industries.

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7 For example, asset size is used to determine whether a bank is small.

8 Small Business Size Standards: Professional, Scientific and Technical Services, 76 Fed. Reg. 14,323, 14,327 (2011).

9 *Id.*

10 76 Fed. Reg. at 14,327

11 *Id.* at 14,331.

12 *Professional Services: Proposed Changes to the Small Business Size Standards; Hearing before the Small Business Committee Subcommittee on Economic Growth, Capital Access and Tax,* 112th Cong. 66-748 (May 5, 2011) (statement of Walter J. Hainsfurther).

The Committee was concerned that limiting the number of size standards available and combining industries into common size standards prioritized administrative ease over providing the best size standards for each industry, and held a hearing on the issue to create a record of its concerns.[13] When the SBA proceeded with these changes in spite of the concerns raised by the Committee and the small business community, the Committee reported out H.R. 3987, the Small Business Protection Act of 2012, which later became law as section 1661 of the FY 13 NDAA.[14]

The FY 13 NDAA altered the SBA's ability to establish size standards in three important ways. First, Section 3(a) of the Act was amended to add a new paragraph (6) addressing the minimum requirements rulemaking pertaining to any size standards.[15] Second, a new paragraph (7) was added to Section 3(a) of the Act to explicitly address the use of common size standards.[16] Finally, paragraph (8) added to Section 3(a) of the Act to address the number of size standards.[17] As will be explained further, the Proposed Rule fails to abide by each of these new requirements.

II. The Proposed Rule

The Proposed Rule violates all three of the new statutory requirements. The SBA took the previous methodology and applied it without any change to 57 industries and five sub-industries, ultimately proposing to increase the size standards for 30 industries and three sub-industries, and to eliminate one sub industry – the ITVAR exception to NAICS 541519 (Other Computer Related Services). As are result, the proposed regulations are themselves fundamentally flawed.

a. Standard for Legal Sufficiency in a Rule

Agencies are normally entitled to broad deference when interpreting their own statute.[18] Specifically, the Supreme Court has held that "[t]he power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress."[19] Therefore, if there is a gap, Congress is deemed to have provided the agency with "an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation," and the decision of the agency will receive deference. [20] However, this deference is not given when regulations are "manifestly contrary to the statute."[21] Such a regulation will not withstand judicial scrutiny as a regulation may not contradict statutory language or congressional intent.

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13 *Professional Services: Proposed Changes tot eh Small Business Size Standards; Hearing before the Small Business Committee Subcommittee on Economic Growth, Capital Access and Tax,* 112th Cong. 66-748 (May 5, 2011).
14 H. Rept. 112-724 (2012).
15 15 U.S.C. § 632(a)(6), as amended by Pub. L. No. 112–239 § 1661, 126 STAT. at 2083.
16 15 U.S.C. § 632(a)(7), as amended by Pub. L. No. 112–239 § 1661, 126 STAT. at 2084.
17 15 U.S.C. § 632(a)(8), as amended by Pub. L. No. 112–239 § 1661, 126 STAT. at 2084.
18 Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837 (1984).
19 Morton v. Ruiz, 415 U.S. 199, 231 (1974).
20 Chevron at 844.
21 Chevron at 844, *see also* Schweiker v. Gray Panthers, 453 U.S. 34, 44 (1981); Batterton v. Francis, 432 U.S. 416, 424-426 (1977); American Telephone & Telegraph Co. v. United States, 299 U.S. 232, 235-237 (1936).

The Proposed Rule violates the Act in three ways. First, it does not follow the Act's dictates regarding proposed rule making. Second, it does not honor the Act's prohibition on common size standards. Finally, it ignores the statutory language regarding limiting the number of size standards. Each violation will now be addressed.

b. Compliance with Section 3(a)(6) of the Act

For any proposed size standard to be valid, SBA must make publicly available a detailed description of the industry, an analysis of the competitive environment for the industry, the approach that the agency used to develop the size standard, and the anticipated effect of the proposed rule on the industry.[22] Specifically, Section 3(a)(6) of the Act states:

> (6) PROPOSED RULEMAKING.—In conducting rulemaking to revise, modify or establish size standards pursuant to this section, the Administrator shall consider, and address, and make publicly available as part of the notice of proposed rulemaking and notice of final rule each of the following:
>
> (A) a detailed description of the industry for which the new size standard is proposed;
>
> (B) an analysis of the competitive environment for that industry;
>
> (C) the approach the Administrator used to develop the proposed standard including the source of all data used to develop the proposed rule making; and
>
> (D) the anticipated effect of the proposed rulemaking on the industry, including the number of concerns not currently considered small that would be considered small under the proposed rule making and the number of concerns currently considered small that would be deemed other than small under the proposed rulemaking.

15 U.S.C. § 632(a)(6).

While the SBA does provide the approach it used to formulate the Proposed Rule, the required analysis is pro forma restatement of its methodology, absent or flawed. For the majority of the 30 industries that face a changed size standard, the only industry description provided is the NAICS code and industry title. Likewise, the SBA's description of the competitive environment provides simply the variables input into the formula outline by the methodology. However, most troubling is the failure of the SBA to take into account the effects of its rulemaking on the industry.

An example of this flawed analysis is the SBA's proposal to eliminate the ITVAR sub-industry size standard. In 2003, the SBA recognized that "many Federal agencies, as well as private sector

22 15 U.S.C. § 632(a)(6).

organizations, look for contractors that ... can provide a range of services that assist and support the acquisition of computer hardware and software [such as] advising an organization on what types of computer equipment, systems, and technologies will fit its needs; designing and integrating systems; purchasing and installing IT equipment; customizing hardware and software configurations; and providing technical services, maintenance, warranty service, and user support."[23] SBA acknowledged that while the customer benefitted from having a single contractor provide goods and services, the SBA's "size standards and program eligibility requirements [did] not specifically address the classification of Federal contracts that combine services with the acquisition of supplies."[24] Specifically, agencies could not use set asides for these contracts due to the applicability of the nonmanufacturer rule.[25] Furthermore, since a large proportion of the value of a contract will be for hardware and software with 20 percent to 30 percent generally for value-added services, the dollar value of the contract did not accurately reflect the size of the company.[26] Therefore, the SBA created a sub-industry of NAICS 541519 for ITVARS on procurements that "must consist of at least 15% and not more than 50% of value added services as measured by the total price less the cost of information technology hardware, computer software, and profit captured."[27] These contracts were still treated as service contracts, therefore the nonmanufacturer rules did not apply, and with a size standard of 150 employees, a small business was not forced to recognize the value of pass-through items when calculating its size status.

However, with the Proposed Rule, the SBA seeks to eliminate the ITVAR exception, and revert to the $25.5 million size standard for those contracts that are primarily services, and to the 500 employee manufacturing size standard for contracts that are majority services. SBA states that "99 percent of firms below the 150 employee level will continue to qualify as small under the $25.5 million receipts-based size standard" so that the rule will have "very minimal impact on businesses below 150 employees."[28] The 2003 rule analyzed ITVARs it compared to firms complying with the nonmanufacturer rule, and contained estimates of the number of federal contracts awarded to ITVARs, which demonstrated that over half of all ITVAR actions and 30 percent of dollars went to businesses that would be considered small ITVARs, however all such data is absent from the Proposed Rule.[29] Indeed, the entire Proposed Rule never even acknowledges the nonmanufacturer rule.

SBA also argues that the ITVAR industry is not unique compared to other types of VARs, but only highlights why it needed to better define the industry as required by the statute. While the SBA states that, "the combination of services and supplies in an acquisition is not unique to the [IT]

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23 "Small Business Size Standards; Information Technology Value Added Resellers" 67 Fed. Reg. 48,419 (2002).
24 "Small Business Size Standards; Information Technology Value Added Resellers" 67 Fed. Reg. 48,419 (2002).
25 13 CFR §121.406. The nonmanufacturer rule requires that a small business receiving a set aside contract provide the products of a small manufacturer, unless the SBA provide a waiver stating that there are no small domestic manufacturers of the product.
26 67 Fed. Reg. at 48,420.
27 "Small Business Size Standards; Information Technology Value Added Resellers" 68 Fed. Reg. 78,833,78,842 (2003).
28 79 Fed. Reg. at 53656.
29 68 Fed. Reg. at 78,837-78,839.

industry," it fails to account for the numerous ways the federal government treats IT purchases differently than other types of purchases.[30] IT is the only category of goods and services to have its only regulatory framework for purchases – the TechFAR – since the purchase of technology involves commercial item procurements, commercial services procurements, noncommercial procurements, procurements involving sensitive and classified information, data rights issues, and numerous other legislative and regulatory anomalies. At no time does the SBA address whether the concerns that led to the creation of the ITVAR size standard still exist today, although a look at major contracts using this exception indicates that federal agencies still prefer to purchase using ITVARs.[31]

Indeed, the idea that a $25.5 million receipt-based size standard is equivalent to 150 employees in this industry is misleading, at best. IT firms paid an annual average wage of $93,800 in 2012, 98 percent more than the average private sector wage of $47,400.[32] While the Committee realizes that executives and highly skilled individuals would be paid more, and others less, using this as the average salary for an employee, the Committee did some calculations. As the following chart illustrates, regardless of whether half of the contractors receipts are for services or only 15 percent of the receipts are for services, simply paying for supplies and the salaries of employees will cause the company to run a deficit.

Receipts of Business	Percentage of Value Added Services	Dollars Spent on Customer Equipment	Number of Employees	Average Employee Salary	Total Salary Expense	Receipts Less Cost of Customer Equipment and Salaries
$25.5 m	50 %	$12.75 m	150	$93,800	$14.07 m	-$1.32 m
$25.5 m	40 %	$15.3 m	150	$93,800	$14.07 m	-$3.87 m
$25.5 m	30 %	$17.85 m	150	$93,800	$14.07 m	-$7.05 m
$25.5 m	20 %	$20.4 m	150	$93,800	$14.07 m	-$8.97 m
$25.5 m	15 %	$20.4 m	150	$93,800	$14.07 m	-$10.25 m

30 79 Fed. Reg. at 53,656.

31 Over 230 small businesses recently submitted offers on the Solutions for Enterprise Wide Procurement (SEWP) V Government Wide Acquisition Contract (GWAC), which uses the ITVAR exception and has a ceiling of $20 billion, nearly quadruple the amount allocated for SEWP IV.
http://washingtontechnology.com/microsites/2013/contract-guide-sewp/01-sewp-evolves.aspx

32 TechAmerica Foundation, Cyberstates: The Definitive State-by-State Analysis of the U.S. High-Tech Industry (2012) available at http://www.techamericafoundation.org/cyberstates. California's tech industry workers were paid the highest annual average wage of $123,900 in 2012, followed by Massachusetts ($116,000) and Washington ($110,200).

However, none of these scenarios allow the ITVAR to pay benefits, taxes, rent, overhead expenses, or collect any profit. Consequently, based on the industry specific characteristics, 150 employees is not the equivalent of $25.5 million – the actual equivalent dollar figure would be significantly higher. The math simply does not work, which the SBA would have realized if it had complied with the underlying statute.

This is not to say that the SBA is incorrect to raise concerns about the potential for abuse of the ITVAR size standard. However, rather than eliminating the ITVAR exception, it could pursue alternate means to address the issues that would not have a negative effect on legitimate ITVARs. These could include requiring that all ITVAR contracts delineate separate pricing for services, that the task order indicate the amount of the purchase allocated for goods versus services, and that contracts using the ITVAR exception include labor categories. Alternately, the SBA could request that the Integrated Award Environment (IAE) modify the Federal Procurement Data System (FPDS) to allow it to track the use of sub-industry size standards. As IAE already intends to revamp FPDS in the next three years, this could be included as part of their work plan. Likewise, IAE is already revising the subcontracting systems, and these systems could be used to see whether contracts awarded using NAICS 541519 are subcontracting more than 50 percent of their dollars for supplies. None of these approaches would burden small businesses, and would have been apparent if the SBA had complied with Section 3(a)(6) of the Act.

c. Compliance with Section 3(a)(7) of the Act

The 2013 changes to the Act limited the ability of the SBA to create common size standards for numerous industries. Specifically, the Act states:

> (7) COMMON SIZE STANDARDS.—In carrying out this subsection, the Administrator may establish or approve a single size standard for a grouping of 4-digit North American Industry Classification System codes only if the Administrator makes publicly available, not later than the date on which such size standard is established or approved, a justification demonstrating that such size standard is appropriate for each individual industry classification included in the grouping.

15 U.S.C. §632(a)(7).

Unfortunately, SBA's disregard of this requirement is even more blatant.

Instead of referring to common size standards, the Proposed Rule refers to anchor size standards, but defines them as "a common size standard for a large number of industries that have similar economic characteristics and serves as a reference point in evaluating size standards for individual industries."[33] Every single size standard considered by the Proposed Rule is based upon these anchor size standards. Unfortunately, there is no justification provided for reliance on

33 79 Fed. Reg. at 53,649.

these common size standards. Instead, the "SBA presumes an anchor size standard is appropriate for a particular industry unless that industry displays economic characteristics that are considerably different from other industries with the same anchor size standard."[34] This reverses the burden of proof established by Congress – it is not incumbent on the industry to prove it is unique; but rather the SBA must prove that an industry is not unique. Even more troubling, the SBA proposes to place the current ITVAR firms into one of the common size standards created in 2012 – the very rulemaking that took effect in 2012 and prompted Congress to change the statute. While the SBA's failure to comply with Section 3(a)(7) of the Act is itself grounds to find the Proposed Rule legally insufficient, it becomes more pernicious when it becomes clear that SBA disregarded this provision due to its hostility to Section 3(a)(8) of the Act.

d. Compliance with Section 3(a)(8) of the Act

The final change to the size standard process made by Congress in 2013 was the prohibition on limiting the number of size standards. Specifically, the Act stated:

> (8) NUMBER OF SIZE STANDARDS.—The Administrator shall not limit the number of size standards established pursuant to paragraph (2), and shall assign the appropriate size standard to each North American Industry Classification System Code.

15 U.S.C. §632(a)(8).

Unfortunately, the SBA continues to limit the number of size standards it will consider, as this Proposed Rule states the SBA proposes to apply only "five employee based size standards to the analysis of employee based size standards for industries in the Manufacturing Sector and other industries not in the Wholesale and Retail Trade Sectors: 500 employees, 750 employees, 1,000 employees, 1,250 employees, and 1,500 employees." [35]

The rationale for this decision is intertwined with the SBA's decision to use common size standards. SBA explicitly states that:

> These long-standing anchor size standards have stood the test of time and gained legitimacy through practice and general public acceptance. An anchor is neither a minimum nor a maximum size standard. It is a common size standard for a large number of industries that have similar economic characteristics and serves as a reference point in evaluating size standards for individual industries. **SBA uses the anchor in lieu of trying to establish precise small business size standards for each industry. Otherwise, theoretically, the number of size standards might be**

34 79 Fed. Reg. at 53,649.
35 79 Fed. Reg. at 53,651.

as high as the number of industries for which SBA establishes size standards (i.e., more than 1,000).

79 Fed. Reg. at 53,649 (emphasis added).

While the Committee does not expect absolute precision, it does expect that the SBA will not simply declare that it will even attempt to comply. The Committee has no objection to 1,000 well reasoned and explained size standards – they would provide greater insight into the health of the small business industrial base, and inform the creation of better statements of work for contracts. Indeed, they could result in more opportunities for small businesses, both at the prime and subcontracting level. They would also mitigate against the problems faced by businesses graduating from their small business size status. Rather than facing a cliff where contracts were no longer available, they could walk down a hill where they gradually lost small business status in various sectors. In any case, if the SBA disagrees with the statutory language, they should approach Congress and ask for a change, not simply disregard the statute. No such legislative proposal has been received by the Committee. Instead, the SBA undertook an irrational rulemaking.

III. The Regulation is Arbitrary and Capricious because it is Irrational

While the Proposed Rule fails since it disregarded the express language of its statute, it similarly fails for its irrationality. Any rule promulgated under the auspices of the Administrative Procedure Act (APA), such as the Proposed Rule, must conform to rational rulemaking.[36] While the focus typically revolves around an examination of whether the agency followed proper procedure, process must result in a substantively rational rule.[37] For a rule to be substantively rational, an agency must address all relevant statutory factors, examine relevant data, and articulate a satisfactory explanation for its course of action.[38] A decision by an agency that is so implausible that it cannot be ascribed to its expertise, or constitutes a clear error of judgment will be considered arbitrary and capricious rulemaking in violation of the APA.[39] An agency that promulgates a regulation in which the rule is not rationally related to its statutory mandate or objectives also will be considered to have acted arbitrarily and capriciously in violation of the APA's mandate of rational rulemaking.[40] As the Proposed Rule directly contradicts the statutory mandate, the two cannot be rationally related. Therefore, the proposed rule fails the test of rational rulemaking mandated by the APA.

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36 5 U.S.C. §§ 500 et seq.

37 *See, e.g.*, Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 547 (1976); Chocolate Mfrs. Ass'n v. Block, 755 F.2d 1098, 1103 (4th Cir. 1985).

38 *See* Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971); *see also* Motor Vehicle Manufacturers Ass'n of the United States v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983); California v. FCC, 905 F.2d 1217, 1230-31 (9th Cir. 1994), *cert. denied*, 514 U.S. 1050 (1995).

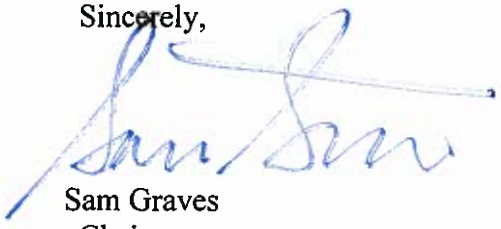
39 Motor Vehicle Manufacturers Ass'n, 463 U.S. at 43; Arent v. Shalala, 70 F.3d 610, 617 (D.C. Cir. 1995), *quoting* Citizens to Preserve Overton Park at 416.

40 *E.g.*, Mourning v. Family Publications Serv. Inc., 411 U.S. 356, 369 (1973); Sidell v. Commissioner, 225 F.3d 103, 106 (1st Cir. 2000); Texas Oil & Gas Ass'n v. EPA, 161 F.3d 923, 935 (5th Cir. 1998); American Paper Inst. v. EPA, 996 F.2d 346, 351 (D.C. Cir. 1993).

IX. Conclusion

For the foregoing reasons, the Committee believes that the Proposed Rule, if promulgated without significant change, is legally insufficient and subjects the SBA to substantial litigation risk. The Committee urges SBA to withdraw the Proposed Rule, and return with a revised rule that complies with the requirements of the Act and the APA. Should the SBA proceed with the rulemaking, the Committee will consider appropriate legislative action.

Sincerely,



Sam Graves
Chairman