August 7, 2008

BY ELECTRONIC MAIL

FAR Secretariat
General Services Administration
Regulatory Secretariat
Room 4035
Attn: Laurieann Duarte
Washington, DC 20405


Dear FAR Secretariat:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits these comments on the FAR Council Employment Eligibility Verification proposed rule.1 Pursuant to the Regulatory Flexibility Act (RFA),2 the FAR Council prepared an initial regulatory flexibility analysis (IRFA) to assess the impact of the regulation on small entities, but ultimately concluded that the rule would not have a significant economic impact on a substantial number of small entities.3 Advocacy commends the FAR Council for including elements of an IRFA in its proposed rule, including an analysis of regulatory alternatives; however, Advocacy is concerned that the Council has not accurately calculated the economic cost of the proposed rule on small entities. Presently, there is not a sufficient factual basis to certify no significant economic impact on a substantial number of small entities; nor do we believe there is sufficient analysis to satisfy the requirements of an IRFA.

Small businesses have raised questions about several aspects of the proposed rule, which we list here, including questions about the accuracy of the E-Verify system. Advocacy recommends that until better data are available, small businesses be exempted from the requirements of the rule, and should not be subject to debarment under the rule until the accuracy level of the E-Verify system has improved.

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1 73 Fed. Reg. 33374 (June 12, 2008).
3 The RFA requires than in any notice and comment rulemaking, an agency must publish an initial regulatory flexibility analysis (IRFA) or certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. See 5 U.S.C. § 603(a), 605(b). If an agency provides a certification in lieu of an IRFA, it must provide a factual basis for that certification. Id.
I. The Office of Advocacy

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA), gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

On August 13, 2002, President Bush signed Executive Order 13272, which requires federal agencies to notify Advocacy of any proposed rules that are expected to have a significant economic impact on a substantial number of small entities and to give every appropriate consideration to any comments on a proposed or final rule submitted by Advocacy. Further, the agency must include, in any explanation or discussion accompanying publication in the Federal Register of a final rule, the agency's response to any written comments submitted by Advocacy on the proposed rule.

II. Background

On June 12, 2008, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) proposed to amend the Federal Acquisition Regulation (FAR) to require certain contractors and subcontractors to use the U.S. Citizenship and Immigration Services' (USCIS) E-Verify system as the means of verifying that their employees are eligible to work in the United States.

The proposed rule would apply only to employment in the United States as defined in section 101(a)(38) of the Immigration and Nationality Act (INA), 8 U.S.C. § 1101, et seq. In other words, the proposed rule does not apply to any employment outside the United States, including work on United States embassies or military bases in foreign countries. Finally, the proposed rule does not apply to any employee hired prior to November 6, 1986, as these employees are not subject to employment verification under INA section 274A, 8 U.S.C. § 1324a.

The proposed rule would apply to government prime contracts that include work in the United States, other than contracts that do not exceed the micro-purchase threshold (generally $3,000), or that are for commercially available off-the-shelf (COTS) items or items that would be COTS items but for minor modifications. The rule also applies to subcontracts over $3,000 for services or for construction.

The rule would amend the covered government contracts by insertion of a new clause (hereinafter “the E-Verify clause” or “the clause”) that would require a contractor or subcontractor to a) enroll in the E-Verify program within 30 days of contract award, b) begin verifying the employment eligibility of all new employees of the contractor or

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subcontractor that are hired after enrollment in E-Verify, and c) continue to use the E-Verify program for the life of the contract. The rule and the clause also require contractors and subcontractors to use E-Verify to confirm the employment eligibility of all existing employees who are directly engaged in the performance of work under the covered contract.

Under the final rule, departments and agencies will be required to amend existing indefinite delivery/indefinite quantity contracts to include the E-Verify clause for future orders if the remaining period of performance extends at least six months after the effective date of the final rule.

In exceptional circumstances, a head of the contracting activity may waive the requirement to include the clause. This authority is not delegable.

**III. Advocacy Recommendations and Comments**

**A. Advocacy encourages the FAR Council to consider small business comments.**

Following the publication of the proposed rule, Advocacy held a roundtable on July 17, 2008, that was attended by small business stakeholders from various industries. Advocacy encourages the FAR Council to carefully consider these comments and other comments filed by additional small business stakeholders.

**B. Advocacy encourages the FAR Council to provide a detailed factual basis for the certification.**

The proposed rule does not allow small businesses to fully assess the impact of the rule because the economic analysis lacks transparency. The economic analysis in the docket is problematic from a methodological point of view because the proposal includes only the number of contracts in FY06, total value of contracts in FY06, and the total value of contracts in FY07. The remainder of the analysis amounts to a series of behavioral assumptions that are neither substantiated nor justified.

1. Based on the numbers outlined above, the total number of contracts is derived by assuming that subcontractors have a 20 percent share, there are 20 percent new contracts per year, and that the total number of contracts grows at five percent per year. If any of these assumptions were to change the total number of contracts in the analysis would be affected. The proposal does not indicate where the percentages came from.

2. The total number of employees is derived similarly. 26 percent of total contracting dollars are assumed to pay for direct labor in order to derive the number of employees in that category. 26 percent of the contract dollars are

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6 The Regulatory Impact Analysis is available in the docket at http://www.regulations.gov/fdmspublic/ContentViewer?objectId=090000648062f87e&disposition=attachment&contentType=msw8. Paragraphs 1, 2, and 3 pull data and percentages from the above referenced document.

also assumed to go to overhead expenses, and 40 percent of these overhead expenses are further assumed to pay for labor. 26 percent of contract dollars are assumed to pay for material expenses, and 20 percent of material expenses are assumed to pay for services purchased (assumed to represent hired subcontractors). Finally, DHS assumes that 20 percent of employees will go through the system every year because they are new hires, and this total number annually grows at five percent. The economic analysis is not explicit about how DHS arrived at these assumptions deriving the total number of employees, and what would happen if the numbers changed.

3. The Memorandum of Understanding (MOU) that contractors will be required to sign in order to use E-Verify has an online tutorial. While the proposed rule acknowledges the tutorial, and that contractors will incur an opportunity cost for learning about the tutorial, it does not acknowledge the requirement that a proficiency test at the end of the tutorial needs to be taken (and a 71 percent pass rate achieved). One must successfully pass this test to gain admission to the E-Verify system. The proposed rule does not discuss the cost implications to an employer who does not pass the test. The costs involved have more dimensions than just the opportunity cost.

The Regulatory Planning and Review section of the rule states that the rule will impact 168,324 businesses (derived from the assumptions described above). The regulatory flexibility analysis states that there will be 162,125 small businesses affected by the rule. The public is left to assume that there are 162,125 small business prime and subcontractors. According to data from the Small Business Administration, in FY 2006 agencies awarded $60,703,667,336 to small business subcontractors. If this amount were distributed to 162,125 small business subcontractors it would mean that each business received on the average a contract valued at $375,000. However, DHS cites the average annual revenue of a ten-person firm as approximately $1.4 million. Accurate subcontracting data is essential because of the uniqueness of this group in the Federal acquisition system. Many subcontractors are specialists and the work they provide is not neatly rolled into a one-year or multiple year contracts.

DHS, in calculating compliance costs for a small business with ten employees, estimated that the firm would have annual revenue of $1.4 million. The agency then takes the compliance cost of $419 for the initial year and reaches a conclusion that the compliance cost is .03 percent of the company’s annual revenue and thus not a significant burden.

There are several problems with this reasoning. DHS did not distinguish between prime small business contractors and small business subcontractors. There is disproportionality in the compliance cost burden on small business subcontractors because there are fewer
avenues and fewer contracts for the small business to spread the cost of doing business. Small business contractors can also vary in size.

Some contractors in the construction or manufacturing industries, for example, can have hundreds of employees and still be considered small. It is doubtful that DHS’ $419 figure is an accurate statement of the costs of the rule to these small businesses.

In addition, profit margins vary by industry. DHS gives no indication that the compliance costs, even very low compliance costs, could be significant for some businesses. Advocacy believes that in order for DHS to accurately gauge whether the economic impact of the rule is significant, the agency must compare a more accurate cost figure with the revenues of small businesses of varying sizes in all of the affected industries. This is especially true when the profit margin on many federal contracts is statutorily established. For example in the architecture and engineering contracting environment the maximum allowable profit margin is 6 percent. If one adds a 10 percent retainage fee, mandatory errors and omission insurance, and the cost of borrowing money (universally recognized as being higher for small businesses), and the upcoming three percent mandatory IRS withholding, then 0.03 percent may become economically significant.

If, after reviewing the comments received regarding its RFA certification, the FAR Council has reason to believe that it can no longer certify that the proposed rule will not have a significant economic impact on a substantial number of small entities, then the FAR Council should examine feasible alternatives that would lessen the burden on small entities. In that event, the FAR Council should also publish an IRFA detailing those alternatives, describing the scope and impacts of the proposed rule on small entities, and provide another opportunity for small businesses to comment prior to publication of the final rule.

C. Small business stakeholders raised other concerns with the proposed rule.

1. Memorandum of Understanding (MOU)

Contractors will be required to sign a MOU that is an agreement between them, the Social Security Administration and the U.S. Citizenship and Immigration Services (USCIS). The proposed rule provides the contractor with an opportunity to negotiate the terms of the MOU. Cost of compliance includes a line item for the contractor’s attorney to read the MOU. The cost of compliance should recognize the cost for an attorney to negotiate an acceptable MOU. Also the proposed rule does not set forth a procedure for the small business owner to resolve conflicts between the terms and conditions of the MOU and the contract. As stated above, employers are required to pass a mastery test with a score of 71 percent or higher on the material presented in the training module.

2. Other employment verification systems

Small business stakeholders expressed concern that they are now being inundated with several significant employee clearance processes that would seem to have the potential

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15 Id., p. 54.
for significant redundancy. For example, Homeland Security Presidential Directive (HSPD-12) and other agency top secret clearance systems ask the employer to provide the same type of information. Redundancy is burdensome to Federal small contractors; in addition to the time each system requires of the contractor, the compliance requirements for each system carry severe penalties for the contractor’s failure to enter correct data.

In the HSPD-12 system, the contractor is required to have each employee certified before entry to the federal building or property is granted. In the proposed E-Verify program, federal contractors are required to validate the employment of each person assigned to the contract. These contractors are submitting the same information on each employee but the information is being submitted to different government systems and thus the potential for duplicative results.

3. Lost work-time hours

Most small business federal contractors are paid based on the number of billable hours of the employee. If the employee is denied admission to the building under HSPD-12 the contractor cannot bill the government. If the employee receives a nonconforming employment verification from E-Verify, the contractor is required to permit this employee the opportunity to go to a local Social Security office to get the information corrected. The employer is not able to bill the government for these lost hours of work on the contract. Small business stakeholders have expressed an interest in the government having a “one stop shop” for employment verification and security clearances.

Thus the employee’s data is entered into a uniform system only once and the potential for harmful burdensome cost should be greatly reduced for small businesses.

D. Small business stakeholders raise concerns regarding the accuracy of E-Verify

According to the Westat report, the E-Verify Web Basic Pilot has grown dramatically since its inception.\textsuperscript{16} The number of employers transmitting cases grew from 1,533 during the first half of FY 2005 to 5,689 in the first half of FY 2007.

The report states that no more than four percent of newly hired U.S. workers were verified using the Web Basic Pilot during the first half of FY 2005.\textsuperscript{17} The Web Basic Pilot System has not had to accommodate the mandatory use by 165,000 small business owners. This system is reported to have a more than 90 percent rate of employment accuracy but with far fewer users than currently being proposed by this regulation. Small businesses are concerned about the potential inability of the system to timely process employment verifications which will create costly delays. The Westat report concludes that while improvements are being made, further improvements are needed, especially if the Web Basic Pilot becomes a mandated national system. Small businesses do not have the financial resources and human capital to adapt their technology infrastructure systems to rapid change requirements being imposed by the


\textsuperscript{17} Id., p. xxv.
Federal government. Small business Federal contractors operate on very thin profit margins and these types of technology systems require capital outlays that cannot be easily recouped by passing the cost to the client and are costly to the small business owner. An example, the Federal Acquisition Streamlining Act of 1994, Public Law 103-355, mandated all businesses move to Electronic Data Interchange systems. This change was a significant cost impact for small businesses. After complying with this requirement, that was in its infancy of development, the Internet came into existence and the government then moved to the internet. Small businesses were required to comply with this new system. The FAR Council should reconsider making this a mandated national system for Federal contractors until the recommendations from the Westat report have been implemented

IV. Recommendations and Conclusion

Advocacy thanks the FAR Council for providing small business with an opportunity to comment on its E-Verify proposed rule. For the foregoing reasons, Advocacy believes that (a) FAR Council should give careful consideration to delaying the mandatory compliance with E-Verify until such time that the Westat improvements have been implemented; (b) if the FAR Council cannot delay the mandatory compliance, then small businesses should be exempted from the requirements of the rule until better data are available on the economic impact and cost of the rule on small businesses; (c) if the FAR Council cannot establish a factual basis for its certification under the RFA, it should publish an Initial Regulatory Flexibility Analysis (IRFA) that would include feasible alternatives that would lessen the compliance burden on small businesses; and (d) the FAR Council should consider the creation of a “one stop shop” for employment verification and security clearances.

Please feel free to contact me or Major Clark at (202) 205-7150 (major.clark@sba.gov) if you have any questions or require additional information.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

Major L. Clark, III
Assistant Chief Counsel for Advocacy

cc: The Honorable Susan E. Dudley, Administrator, Office of Information and Regulatory Affairs