THE WALSH-HEALEY PUBLIC CONTRACTS ACT
AND
SMALL FIRM COMPETITIVENESS IN FEDERAL ACQUISITION

Prepared for:
The U.S. Small Business Administration
Office of Advocacy
Under Contract No.
SBA-9273-AER-85

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ACKNOWLEDGEMENTS

This study has required the input and involvement of numerous professionals located throughout the country. Without the giving of their time and insights, this report would not have been possible. Research Dimensions, Inc. (RDI) is particularly grateful for the contributions of the SBA procurement assistance professionals located throughout the country. These professionals—the administrators, lawyers, CoC program industrial specialists, and procurement assistants—are those who daily have the responsibility of implementing the law—of shaping the law through their countless interpretations and actions. These professionals are listed by SBA region on the page following this acknowledgement.

Also, RDI is grateful for the input of numerous contracting officers and DCAS (Defense Contract Administration Service) personnel whose decisions and professional opinions were gleaned from the hundreds of Walsh-Healey case files reviewed during the course of this research. Again, their daily actions and interpretations contribute to the molding of the law and its impact on small firms.

William Gross from the U.S. Department of Labor (DoL), Employment Standards Administration, Wage and Hour Division, contributed to this research by sharing his experiences and knowledge of the Walsh-Healey implementation process from the DoL perspective. Additionally, his patience in locating valuable Walsh-Healey historical files, i.e., Administrator Circular Letters, proceedings of administrative hearings, etc. unquestionably have contributed to what, we hope, is the presentation of a balanced historical perspective of Walsh-Healey regulatory developments.

Also, RDI is grateful for the insights gleaned from the officials of small firms supplying products to the Federal government, but denied contracts on the basis of failure to meet Walsh-Healey eligibility requirements. Their willingness to share experiences and perspectives regarding the impact of Walsh-Healey on their businesses is a vital requirement for effecting change.

Finally, RDI is grateful for the contributions of James E. Ferrerio who served as project consultant. His years on the firing line in the SBA CoC program and his involvement in numerous Walsh-Healey eligibility determinations were invaluable contributors to this analysis.
In conclusion, while many professionals have contributed to this research, RDI takes ultimate responsibility for the findings and conclusions outlined in this report. It is hoped that this effort will provide the foundation for considered discussion and thoughtful, but needed change.

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PREFACE

Interestingly, the problems discussed in this analysis were predicted in testimony before the House Committee on the Judiciary in 1936. Specifically, the Associate Counsel for the National Association of Manufacturers, in opposing the Healey Bill, H.R. 11554, stated "...it is obvious that the imposition of restrictive conditions upon bidders narrows the field of competition, increases the cost of goods to the Government, and tends directly toward monopoly. Such a system operates with especial harshness against small bidders who can not maintain staffs in Washington on the one hand, or who can not possibly absorb the additional costs of compliance and regulation on the other. It also restricts the production of goods for Government use as against goods produced for private markets, thus diminishing the extent of industry available to serve Government requirements..."

--U.S. Congress. House of Representatives Committee on the Judiciary
Hearings. Conditions of Government Contracts
March 16-23, 1936.
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CHAPTER I. THE ORIGINS OF THE WALSH-HEALEY PUBLIC CONTRACTS ACT: WHAT WAS CONGRESSIONAL INTENT?

OVERVIEW

The Walsh-Healey Public Contracts Act, enacted in 1936, provides "conditions for the purchase of supplies and the making of contracts by the United States, and for other purposes." This chapter reviews the origins of the Act, provides a brief legislative history of events leading up to the Act's passage, and explores Congressional intent in passing the Act.

The chapter demonstrates that Congressional interest in passing the Walsh-Healey Public Contracts Act focused on utilizing the public contracting mechanism to improve labor standards. It emphasizes that Congressional concern over the awarding of contracts to "bid brokers" was linked to the unfair treatment of labor resulting from their subcontracting practices. Finally, the chapter emphasizes that the incorporation of the terms, "regular dealer" and "manufacturer", into the Walsh-Healey Public Contracts Act was an attempt to ensure that the Federal government, in its supply contracts, deal only with responsible contractors, thereby eliminating the possibility of contracting with bid brokers. The incorporation of these terms was necessary because Federal acquisition statutes governing "responsibility" on the part of contractors were practically nonexistent in 1936. Specifically, responsible supply contractors were defined in terms of their ability to furnish a performance bond.
The Walsh-Healey Public Contracts Act, 41 U.S.C. 35-45, was born in an era of labor reform—reforms spurred by the job insecurity of the depression, union protests for a better working environment and rising national awareness of and concern over unfair labor practices. In the 1920's Samuel Gompers, President of the American Federation of Labor, said that the unions simply sought "Better pay, better hours, better working conditions." By the mid 1930's, Congress held the same goals as the unions and adopted several pieces of legislation which contained provisions for fair labor standards, including the Walsh-Healey Public Contracts Act.

Labor Conditions Prompting National Concern. The conditions which prompted national concern over labor issues were four-fold:

First, factories were over-crowded and unsanitary. In addition, few factories took precautions to ensure the safe operation of equipment. These factors rendered many of the production workers disabled, either by illness or injury, and consequently, unable to support their families which were most likely living in poverty.

Second, child labor was considered an essential part of the production process. The children were paid much less than their adult counterparts and kept working long hours through corporal discipline. Concern over this practice mounted when it became evident that the generations of child laborers were growing up with little or no education.

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and reading ability. A call for mandatory education ignited a wave of child labor reforms.

Third, factory employees, children, women, and men alike, were forced to work long hours. At the turn of the century, adult production workers stayed in the factories 12-14 hours each day; by 1929, the average minimum work day had just broken under 10 hours.²

The final issue was also, perhaps, the most pressing, low wages. During the late 1920's, the Louisiana Commissioner of Labor reported that some restaurants were paying their workers $0.06 per hour. At the same time sweat shops in Massachusetts paid as little as $0.01 per hour. In addition, garment shops in New York City were hiring young females for little or nothing with the promise of higher wages as soon as they completed a training period, and then discharging them at the end of their training.³ The low wages took their toll, leaving many families struggling to survive. In 1929, the Brookings Institution released a study on poverty which found that 42 percent of American families lived at or below the subsistence and poverty level.⁴

The severity of the existing labor conditions were compounded by declining economic circumstances which accompanied the depression of the early 1930's. By 1933 national unemployment reached 25 percent and the Gross National Product fell 30.5 percent in real terms due to a 50 percent reduction in industrial production.⁵ With this depression came rising concerns over job security and increasing public demands for minimum wage requirements. The Federal government also sought to reduce the unemployment level

² Ibid. p.598.
⁴ Kelley. p.598.
by enacting maximum hour ceilings for workers, in the hope that factories would respond by hiring more workers to cover the remaining production hours.

The 1930's--A Decade of Labor Reform. Thus, the stage was set for a complete reform of labor practices via a decade of labor legislation. The National Industrial Recovery Act of 1933 (NIRA) was the first attempt at an umbrella solution to the problem, with wide ranging improvements of unfair labor practices in the United States. NIRA declared that "employers shall comply with maximum hours of labor, minimum rates of pay and other conditions of employment, approved or prescribed by the President." Although NIRA was found unconstitutional in May of 1935, it demonstrated the willingness of Congress to find Federal solutions to the nation's existing labor inequities.

A BRIEF HISTORY OF THE WALSH AND HEALEY BILLS

Senate bill, S. 3055, commonly known as the Walsh Bill, was introduced by Senator David Walsh on June 14, 1935 and referred to the Committee on Education and Labor. This bill with several amendments was passed by the Senate on August 13, 1935.

The purpose of the Walsh bill was described in the Senate report as follows: "to direct Government purchases along lines tending

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to maintain the advance in wages and purchasing power achieved under the National Recovery Administration (NRA). Its effect will be to set a standard of wages and hours of labor which otherwise is threatened in view of the abandonment of NRA. It will end the present paradoxical and unfair situation in which the Government, on the one hand, urges employers to maintain and uphold fair wage standards and, on the other hand, gives vast orders for supplies and construction to the lowest bidder, often a contractor or manufacturer who does not sympathize with and fights hardest against labor and social welfare policies."

To accomplish this purpose, the Walsh bill required that "a contract for the sale of supplies to the Government shall contain an agreement by the seller that his employees engaged in the production or furnishing of such supplies have been paid...not less than the minimum rates of pay and employed not exceeding the maximum hours specified ...by applicable and approved N.R.A. code, or in the absence thereof, by applicable President's Reemployment Agreement." 8

The Senate report, outlining the terms of S. 3055, states that "the bill has been prepared upon the theory that Congress has

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8 Ibid.
power to prescribe conditions in public contracts, loan, or grants, and adopt such policies as conditions in them and to direct or authorize the President with respect to their effectuation."

The Walsh bill was referred to the House Committee on the Judiciary on August 13, 1935 where hearings were held soon after. These hearings reflected concern over various aspects of the bill, and as a result, a revised bill, H.R. 11554, more commonly known as the Healey bill, was introduced by Congressman Arthur Healey on March 2, 1936 and referred to the House Committee on the Judiciary.

The major differences between the Walsh and the Healey bills were as follows:

---in the Walsh Bill, the regulations governing minimum wages and maximum hours for employees were to extend not only to Federal contractors, but also to persons obtaining Government loans and grants. The Healey Bill, in order to enhance the enforcement power of the U.S. Department of Labor, excluded this requirement.

---in the Walsh Bill, the regulations were to extend to the subcontracting level to include...
all firms which provided supplies or raw material to the contractor. The Healey Bill excluded this requirement.

—in the Walsh Bill, minimum wages and maximum hours were to be governed by established NRA codes, or in their absence, by the applicable President's Reemployment Agreement. The Healey Bill deleted this requirement, substituting instead prevailing wages for persons employed in a given industry or similar industries operating in the locality.

On June 5, 1936, the House Committee on the Judiciary reported S. 3055 with amendments. The bill, as reported, was a substitute for the earlier Walsh Bill. After further debate and amendment, the Bill passed the House; the Senate agreed to the House amendments on June 20, 1936. The bill became Public Law 846 on June 30, 1936.11

THE ISSUES REFLECTED IN THE CONGRESSIONAL HEARINGS

Three central issues governed the debate and testimony offered during the Congressional hearings surrounding the Walsh and the Healey Bills: a) that the Government attempt to improve labor standards by requiring that its contractors provide decent wages and working conditions for their employees; b) that the Federal government eliminate its dealings with bid brokers who purposefully bid low on Federal contracts and then subcontract the work to contractors in "low wage areas" who provided sweatshop working

11 Ibid.
conditions for their employees; and c) that the Government only contract with "responsible" contractors that would provide decent wages and working conditions for their employees. Each of these issues is described in the following sections.

**Improvement of Labor Standards.** The perceived intent of Congress to improve labor standards through its public contracting activities is reflected through a variety of testimony provided during the Hearings before the House Committee on the Judiciary. Specifically, David Walsh, Senator from Massachusetts and sponsor of Senate Bill, S. 3055, stated "This bill is an attempt to lift up and preserve minimum standards of labor in contracts with the government...I personally think it is vastly more important to require the human element to be protected than the material element in a contract."12

Additional witnesses providing testimony also offered perceptions regarding Congressional intent. Specifically, Dr. Courtney Dinwiddle of the National Child Labor Committee offered the following observation: "It seems to me that the essence of the matter is this: that there are certain standards of wages and hours under which it is practically impossible for people to live

as human beings; and that they are also bound to destroy the very industry in which they are practiced. The purpose of this bill, as I understand it, is to see that the government does not lend itself to perpetuating such conditions, but rather, that its influence be on the other side."¹³

Frances Perkins, Secretary of Labor, in commenting on the Healey bill stated "this ... bill which is before you is a very important step and rests upon practices which are already familiar to the government. After all, the principle involved is ... that the government should be a model employer and that those who work directly for the government should receive the prevailing wage and work the number of hours and under conditions which are regarded by the community as being the best. ... A bill of this sort will add encouragement to the movement which is so general today in the U.S., to maintain good working conditions."¹⁴

Finally, Arthur Healey, in a report of approval, after final review of the bill by the Committee on the Judiciary, stated:

The object of the bill is to require persons having contracts with the government to conform to certain


¹⁴ Ibid, p. 222.
labor conditions, i.e., minimum wage, maximum hours, safe and sanitary working areas, in the performance of the contracts and thus to eliminate the practice under which the government is compelled to deal with sweat shops.¹⁵

The Deterrence of Bid Brokering. Bid brokering became an issue in the Congressional hearings surrounding H.R. 11554 because brokers often subcontracted work out to sweat shops and to other businesses with questionable labor practices. This practice was described in the report of approval after final review of H.R. 11554 as follows:

Testimony was offered by various purchasing officers of the government showing that many persons who were not legitimate dealers nor manufacturers made a practice of bidding for government contracts by submitting estimates so low that none of the well established concerns in the field could successfully compete against them. These brokers then sublet various portions of the contract to sweat shops and substandard factories thus successfully thwarting all attempts by the Federal and State governments to insist upon fair labor conditions in the performance of public contracts. Moreover, the impact of such competition upon legitimate business tends to impair wage and hour standards of entire industries.¹⁶


¹⁶ Ibid.
Raymond Fitzgerald, Attorney, U.S. Department of Labor, in testimony before the House Committee on the Judiciary described the discovery of the practice of bid brokering as follows:

The expression "bid brokers" or "bid peddlers" originated, or at least came to be common usage, among the corps of National Recovery Administration field investigators, especially those assigned to the metropolitan district of New York, during the 3 month period when the Government Contracts Division field office requested and received weekly and sometimes daily copies of bid contracts and purchase orders from the purchasing officers of the several governmental agencies within the territories assigned for their coverage...The investigator...visited the office, factory, or plant, where he requested from the owner, factory superintendent, or executive in charge, information on the wage and hour conditions substantiated by books and payrolls. The majority of plant and factory visits resulted in the sort of evidence requested, and in fact, many office visits did likewise. In other cases, information was given without proof, that is, without books and payrolls, while in still others information was refused. As the investigators became more experienced in the work, it became apparent to them that there was a considerable number of so-called 1 man firms, that is, a bidder on Government contracts maintaining an office in New York city with possibly one clerk or a stenographer or two; that in many cases such an outfit bore a firm name carrying the implication that it was engaged in the production of certain commodities; that in many cases such so-called firms had absolutely no connection with any shop, factory, or plant fabricating commodities, nor did they have any connection as representatives or selling agents for anybody or anything; that, in fact, they were really in the business of bidding on Government contracts; that if successful, such contracts were sublet elsewhere, and in many cases, where the contract was of a sort which could be split up, the component parts were sublet to widely separated sections of the country.17

Additionally, Mr. Fitzgerald offered the following information about the nature of bid brokering:

"The expressions bid peddlers, bid brokers, catalog bidders, mail order bidders, low wage areas, high wage areas, decent wage areas, adequate wage areas, home work, and so forth now became common usage among the investigators to ... characterize certain activities disclosed to them in their work.

Bid peddler or bid broker referred to the individual or "firm", usually a 1 man firm, who without pretense of factory, shop, or fabricating personnel alliance, bid and oftentimes received awards of Government contracts, and who, upon award, proceeded to assign or sublet in whole or into several component parts, if the work to be done or materials furnished lent themselves to divisibility, to others for performance.

Catalog bidders and mail order bidders are somewhat synonymous. These expressions referred to the bid brokers or bid peddlers who, by use of comprehensive catalogues of firms, locations, prices, and areas, were able to parcel out either the complete contract or the divisible type into so-called "low wage areas" thus enabling them to underbid firms or factories which operated in so called high, adequate, or decent wage areas....low wage area came to mean an area where wage and hour conditions prevailed which did violence to the ordinary American concept of decent living conditions.  

Finally, Senator Walter (Pennsylvania) summed up the Congressional feeling about bid brokers in his statement before the committee:

It is the desire of a great many of the members of Congress to see to it that our government does not deal with people who operate sweatshops and does not permit them to secure the benefits of Government business...I am interested in seeing

18 Ibid, p. 201.
that reputable manufacturers of every state are
not compelled to compete with people who employ
practices in their plants that these reputable
manufacturers do not employ and would not toler-
ate...The present bill suggests that the concern
is due to persons obtaining contracts by being
the lowest responsible bidders and then pro-
ceeding to fulfill the contracts by using
wages and hours and other working conditions
that are substandard for their industries.¹⁹

Federal Statutes and Their Contribution to the Deterrence
of Bid Brokering in Federal Contracting. Given that Congress
wanted to ensure that bid brokers did not receive Federal
contracts, a search was initiated during the hearings on
H.R. 11554 to identify Federal acquisition statutes which would
protect the Government against this practice. The most critical
acquisition statute, Section 3709 of the Revised Statutes—the
basic procurement statute until the Armed Services Procurement
Act was passed in 1948—provided, however, that a contract must
be advertised and let to the lowest responsible bidder.²⁰ In
1936, the test of responsibility on general Federal supply
contracts centered on whether the contractor was able to furnish
a performance bond. As such, this statute did nothing to protect
the Government from bid brokers or bid peddlers who could easily
have obtained such bonds, according to testimony.

¹⁹ Ibid, p. 337, 441.

²⁰ Thybony, William W. Government Contracting Based on
the Federal Acquisition Regulation (FAR) (And the Competition
in Contracting Act of 1984). First Revision. Reston, Virginia:
In the course of the hearings, however, O.R. McGuire, Counsel for the Comptroller General, identified a provision in the Navy Department Statutes which stated "that the contract shall be awarded to a manufacturer or a regular dealer." McGuire maintained that this provision "would exclude the bid broker." He further stated that "they can, as I understand it, eliminate the possibility of their contracts going to bid brokers by virtue of that statute." He further cited the specific statute which mandated that "...if more than one bid be offered by any one party by or in the name of his or their clerk, partner, or other person, all such bids may be requested, and no person shall be received as a contractor who is not a manufacturer of or regular dealer in the articles which he offers to supply. (Section 3722 of the Revised Statutes, originates in the Act of March 3, 1863, 12 Stat. 828)."

As a result of McGuire's testimony, the requirement was added to S. 3055, the substitute for the earlier Walsh Bill, that in supply contracts of $10,000 or more the contractor must be a manufacturer or a regular dealer in the materials, supplies, articles, or equipment to be manufactured or used in the performance of the contract.

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22 Ibid, p. 507.
23 Ibid, p. 507.
MANIFESTATION OF CONGRESSIONAL INTENT IN THE ACT

A closer look at the legislation itself should further identify the intent of Congress to improve labor standards. The first two sections of the Act, as codified in Title 41 of the United States Code, are summarized as follows:

Section 35: Stipulations and regulations for supply contracts of $10,000 or more.

a) That all persons employed by the contractor will be paid, without subsequent deduction or rebate, not less than the minimum wage for that job in that industry and area.

b) That no person employed by the contractor shall be permitted to work more than 40 hours in any one week.

c) That no male employed by the contractor shall be less than 16 years old; no female less than 18 years old. In addition, no convict labor will be employed.

d) That no employee shall work in hazardous or unsanitary surroundings.

Section 36: Any violations of the stipulations in Section 35 shall render the party responsible to the U.S. government for damages plus the sum of $10.00 per day for each underage employee or convict laborer knowingly employed plus a sum equal to any under payment of wages in the performance of the contract.

It is evident from four of the stipulations in Section 35 and from the breaches of the law which hold financial penalties as described in Section 36, that Congressional intent was centered on labor issues. This emphasis on labor continues throughout the
history of the Act, including its amendments and the Supreme Court cases it has sparked.

Also in Section 35 is a stipulation that outlines the concern of Congress that contracts subject to the Act should only be awarded to responsible contractors. Specifically, the stipulation states:

a) That the contractor is the manufacturer of or a regular dealer in the materials, supplies, articles, or equipment to be manufactured or used in the performance of the contract.

Conclusion. Throughout the history of the Walsh-Healey Public Contracts Act, Congressional intent and legislative interpretation has been labored centered. Bid-brokers became a target in the fight against unfair labor policies, not because of their bidding procedure, but rather due to their practice of subcontracting to sweat shops.

The incorporation of the terms, regular dealer and manufacturer, into the Act was an attempt to ensure that bid brokers were eliminated from receiving Federal contracts. The incorporation of these terms was necessary in an era when the Federal acquisition statutes only defined a "responsible" contractor in terms of the ability to post a performance bond.
II. THE IMPLEMENTATION OF WALSH-HEALEY: WHAT FUNCTION IS SERVED IN FEDERAL CONTRACTING TODAY?

OVERVIEW

This chapter examines the regulations governing the implementation of the Walsh-Healey Public Contracts Act and reviews the implementation process as it occurs in Federal agencies. The Chapter also examines the purpose served by the Act in Federal procurement today, as perceived by U.S. Department of Labor and SBA officials as well as a select number of contracting officers. The chapter concludes that if the Act does serve a purpose in Federal acquisition today, it functions to deter or prevent bid brokers from receiving Federal contracts. In this process, the issue of upholding decent conditions for labor appears to have become de-linked. No cases of bid broker subcontract arrangements where poor labor conditions were evident were identified during the course of this research.

THE IMPLEMENTING REGULATIONS

The guidelines governing the implementation of the Walsh-Healey Public Contracts Act are outlined in a series of regulations developed by the U.S. Department of Labor, the Federal agency responsible for the Act's implementation. These regulations
comprise Title 41, Part 50-201 of the Code of Federal Regulations. Further guidance regarding implementation is provided through a series of regulations developed by the U.S. Department of Labor that comprise Title 41, Part 50-206, The Walsh-Healey Public Contracts Act Interpretations. The purpose of these latter regulations is to provide guidance for agencies of the United States in matters related to implementation of the Act.

Application of the Regulations. The implementing regulations apply to all contracts entered into by an executive department, independent establishment, or other agency of the United States for the manufacture or provision of materials, supplies, articles, and equipment (Section 50-201.1). As mandated by the Act, the implementing regulations do not apply to contracts of less than $10,000. Also, the implementing regulations outline certain statutory exemptions to the provisions of the Act and grant exemptions from the provision of the Act to certain classes of contracts, i.e., contracts for public utility services, etc. Additionally, the regulations grant partial administrative exemptions to certain types of contracts.

Labor Provisions. The implementing regulations detail the types of employees affected by the Act and discuss the treatment of labor in terms of acceptable maximum hours worked and minimum
wages paid. The regulations also outline acceptable overtime hours and rates of overtime compensation. They also detail procedures for employer protection against the unintentional employment of underage minors. Finally, the regulations detail the types of records of employment that each contractor must maintain.

Generally, the labor provisions outlined in the implementing regulations adhere to those outlined in the Fair Labor Standards Act of 1938. In this context, the Act's stipulations are applicable only to those employees engaged in manufacturing, assembling, handling, supervising, or shipping materials, etc. required under a contract and are not applicable to employees performing only office or custodial work, or to any executive, administrative, or professional employee or salesman (Sec. 50-201.102). Determinations of prevailing minimum wages or changes in the prevailing minimum wages were to be sent to contracting officers by the Department of Labor (Sec. 50-201.1101). Also, in determining the hours for which an employee is employed, any time which was excluded by Section 3(o) of the Fair Labor Standards Act of 1938, as amended, was also to be excluded (Sec. 50-201.106).

Regular Dealers and Manufacturers. In keeping with the legislative mandate, the implementing regulations emphasize that
in order to receive Federal contracts subject to the Act, the bidder or contractor must be a manufacturer or regular dealer in "the materials, supplies, articles, or equipment to be manufactured or used in the performance of the contract." The regulations further specify that "a manufacturer is a person who owns, operates, or maintains a factory or establishment that produces on the premises the materials, supplies, articles, or equipment required under the contract and of the general character described by the specifications" (Section 50-201.101 (a)(1)). A regular dealer is defined to be "a person who owns, operates or maintains a store, warehouse, or other establishment in which the materials, supplies, articles, or equipment of the general character described by the specifications and required under the contract are bought, kept in stock, and sold to the public in the usual course of business" (Section 50-201.101 (a)(2)). Alternative definitions of regular dealer are provided for dealers in machine tools; hay, grain, feed, or straw; raw cotton; green coffee; petroleum; agricultural liming materials; tea; raw or unmanufactured cotton linters; and automatic data processing equipment (Section 50-201.101(a)(iii)-(x)).

Regular Dealer Interpretations. Interpretations of the definition of "regular dealer" and "manufacturer" have also been issued by the U.S. Department of Labor, Employment Standards Administration, Wage and Hour Division (Section 50-206). As
currently outlined in the regulations, in order to qualify as a "regular dealer" for purposes of Walsh-Healey regulated supply contracting the following must be demonstrated before the award:

a) that the bidder has an establishment or leased or assigned space in which it regularly maintains a stock of goods in which it claims to be a dealer; if the space is a public warehouse, it must be maintained on a continuing and not on a demand, basis (Section 50-206.53 (b)(1));

b) that the stock maintained is a true inventory from which sales are made; the requirement is not satisfied by a stock of sample or display goods, or by a stock consisting of surplus goods remaining from prior orders, or by stock unrelated to the supplies which are the subject of the bid, or by a stock maintained primarily for the purpose of token compliance with the Act from which few, if any, sales are made (Section 50-206.53 (b)(2)).

c) that the goods stocked are of the character as the goods to be supplied under the contract; to be of the same general character, the items to be supplied must be either identical with those in stock or goods for which dealers in the same line of business would be an obvious source (Section 50-206.53(b)(3)).

d) that sales are made regularly from stock on recurring basis; they cannot be only occasional and constitute an exemption to the usual operations of the business; the proportion of sales from stock that will satisfy the requirements will depend upon the character of the business (Section 50-206.53(b)(4));

e) that sales are made regularly in the usual course of business to the public, i.e., to purchasers other than Federal, state, or local government agencies; this requirement is not satisfied if the contractor merely seeks to sell to the public but has not yet made such sales; if Government agencies are the sole purchasers, the bidder will not qualify as a regular dealer; the number and amount of sales which must be made to the public will necessarily vary with the amount of total sales and the nature of the business (Section 50-206.53 (b)(5)).
f) that the business is an established and going concern; it is not sufficient to show that arrangements have been made to set up such a business (Section 50-206.53(b)(5)).

Manufacturer Interpretation. To qualify as a manufacturer under Walsh-Healey regulated contracts, a bidder must show before the award the award that it is 1) an established manufacturer of the particular goods or goods of the general character sought by the government, i.e., that the bidder has a plant, equipment and personnel to manufacture on its own premises the goods called for under the contract or 2) if the bidder is "newly entering" into such manufacturing activity that the bidder has made all necessary prior arrangements and definite commitments for (i) manufacturing space, (ii) equipment, and (iii) personnel to perform on its own premises the manufacturing operations required for the fulfillment of the contract (Section 50-206.51(b)).

Manufacturer Assembler Interpretation. The implementing regulations also provide interpretations for a manufacturer assembler (Section 50-206.52). In these provisions "assembly' means piecing or bringing together various interdependent or related parts or components so as to make an operable whole or unit....A firm which produces final items on its premises by assembling component parts, all or some of which have been purchased from others will generally be considered to be 'a manufacturer' where it performs a series of assembly operations
utilizing machines, tools, and workers which constitute substantial and significant fabrication or production of the desired product." The qualification of a bidder as a manufacturer who proposes to "assemble" must be decided on the basis of all the facts and circumstances surrounding a particular procurement (Section 50-206.52 (b)(1)).

Further, the determination of whether a bidder proposing to assemble the final product from component parts is an eligible manufacturer must rest, according to the regulations, on whether the bidder has demonstrated an independent ability to perform a significant or substantial portion of the manufacturing operations required in producing the final product that the government is procuring. Alternatively, a bidder may qualify as a manufacturer if it has the facilities to produce on its own premises a significant portion of the component parts required for the final product even if it intends to perform only assembly operations under a specific procurement. Firms which perform only minimal operations upon the item being purchased cannot qualify as manufacturers (Section 50-206.52 (b)(2)(3)(c)).

Finally, it should be emphasized that the regulations as written work to the disadvantage of "regular dealers" when compared to "manufacturers." Specifically, manufacturers can sell exclusively to the government, or can even be a newly entering firm, whereas a regular dealer can be neither.
Procedures for Determining Contractor Eligibility. The implementing regulations also delineate procedures for determining contractor eligibility to receive Federal contracts subject to the Act's provisions (Section 50-201.101). Specifically, a determination regarding contractor eligibility rests first with the contracting agency. In making such determinations, the contracting agency obtains and considers all available factual evidence surrounding eligibility for all bidders in line for award of contracts subject to the Act. Further, the contracting agency investigates and determines the Walsh-Healey eligibility status of a bidder in all of the following circumstances: a) in cases where the bidder has not previously been awarded a contract subject to the Act by the individual procuring office; b) where a pre-award investigation of the bidder's operations is otherwise made to determine the technical and production capability, plant facilities and equipment, subcontracting and labor resources of the bidder; c) in all cases where there is a protest of a bidder's eligibility; and d) in all cases where a contracting officer may have reason to question a bidder's eligibility.

The implementing regulations give further guidance to the processing of these eligibility determinations. Specifically, the regulations state that when a determination has been made that an apparently successful bidder is ineligible, the contract-
ing officer promptly will notify the bidder in writing that it does not meet the eligibility requirements and will outline the specific reason for the ineligibility determination. Further, the contracting officer will indicate that if the bidder wishes to protest the determination, it may submit any evidence concerning its eligibility to the contracting officer within a reasonable period of time. Finally, if the contracting officer does not reverse the decision after reviewing the evidence submitted by the bidder, the officer must notify the bidder of this determination and the reasons underlying this determination. At this point, if the bidder still disagrees with the finding, the bidder's protest, along with all pertinent evidence will be forwarded to the Administrator of the Wage and Hour Division of the Department of Labor for a final determination, and the bidder notified to this effect.

In cases where the bidder is a small business concern, all ineligibility findings, and all evidence related to these findings, will be forwarded to the Administrator of the Small Business Administration. These cases will be forwarded regardless of whether the small business concern protests the determination, and the bidder or offeror notified to that effect (Section 50-201.101(b)(6)).
SBA Role in Eligibility Determinations. The regulations also provide guidance to the Small Business Administration in reviewing ineligibility determinations. The regulations require that the Administrator of the Small Business Administration review the findings of the contracting officer and either dismiss it and certify the small business concern to be eligible for the contract award in question. In cases where the Small Business Administration concurs with the finding, the matter is forwarded to the Administrator of the Wage and Hour Division, U.S. Department of Labor, for a final determination, in which case the Small Business Administration may certify the small business only if the Wage and Hour Division finds the small business to be eligible. The Small Business Administration is bound by the regulations and interpretations of the Department of Labor in all eligibility determinations under the Public Contracts Act (Section 50-201(b)(6)(c)(2)).

THE FORMAL IMPLEMENTATION PROCESS

Of central importance to procurement officials who implement the Walsh-Healey Act is that section of the implementing regulations which deals with the determination of contractors that are eligible to receive Federal supply contracts that are subject to the Walsh-Healey Act (Section 50-201.101).

In Federal contracting today, five types of procurement officials may become involved in the actual implementation of the Walsh-
Healey Public Contracts Act. The first official is the agency contracting officer who must make the first determination as to the contractor eligibility on Walsh-Healey regulated contracts. In cases where a firm has never contracted with the agency before, the implementing regulations require that the contracting officer make an investigation as to firm eligibility. In other cases, the contracting officer may simply determine that a question of eligibility exists and request an investigation to this effect. In other cases where third party bid protests arise to question a firm's eligibility, the contracting officer also is required by the implementing regulations to make a determination of eligibility.

Once a contracting officer questions a firm's eligibility, a Pre-Award Survey to investigate and verify this eligibility is requested by certain agencies. For General Services Administration (GSA) purchasing offices, a GSA Plant Facilities Survey may be requested. For Department of Defense agencies, this pre-award survey is conducted by the Defense Contract Administration Service (DCAS). At this point, a second procurement official becomes involved in the eligibility determination process. This official is the pre-award survey monitor who conducts an on site visit to the firm's place of business for eligibility determination purposes. This official, based on a complete investigation of the firm's facilities, then makes a recommendation as to the firm's eligibility under the Walsh-Healey Public Contracts Act,
and sends this recommendation to the contracting officer. Based on the recommendation of the pre-award survey monitor, the contracting officer then makes a Determination of Responsibility/Nonresponsibility. If a determination of responsibility is issued, the contract is usually awarded to the firm, assuming that the firm is the lowest bidder. In the case of small firms, if a determination of nonresponsibility is issued, a third procurement official becomes involved in the eligibility determination process. Specifically, the contracting officer then must notify an SBA procurement official of this determination and request that the agency investigate the determination to either verify or overturn it through the issuance of a Determination of Eligibility.

Finally, a fourth Federal official becomes involved in the Walsh-Healey eligibility determination process in the case of regional SBA office decisions to decline certification on the basis of Walsh-Healey. This official resides in the SBA Central Office, notably the Office of Procurement Assistance. The Central Office official will review the case, and according to the provisions of P.L. 95-89, will forward the file to the U.S. Department of Labor if the regional recommendation is upheld. At this point, a fifth Federal official becomes involved in the eligibility determination process, notably an official of the Employment Standards Administration, Wage and Hour Division, U.S. Department of Labor.
This official then makes a final determination regarding the eligibility denial, i.e., either concurs or refutes the SBA Central Office position.

Additionally, it should be emphasized that a U.S. Department of Labor official can also become involved in a Walsh-Healey eligibility determination when small firms choose not to file for an eligibility determination. In these cases, the U.S. Department of Labor must now be apprised of these "no file" cases, and formally acknowledge the "no file" by officially closing the case.

THE INFORMAL IMPLEMENTATION PROCESS

As indicated above, responsibility for implementing the Walsh-Healey regulations rests with the various procurement officials located throughout the Federal government. The actions of these officials—registered through their decisions and interpretations of implementing regulations—form the actual or informal process by which the Walsh-Healey Public Contracts Act is implemented.

In examining this informal process, it can be determined that interpretation of the regulations plays a major role in any final determination of contractor eligibility. Strict interpretations can often result in rejection or contract denial; more liberal interpretations can often result in a decision to issue the contract.
Based on results of this research, several areas of the existing Walsh-Healey regulations lend themselves to differing interpretation. These areas are discussed in the sections below.

That the goods stocked are of the same general character as the goods to be supplied under the contract. While the regulations continue by stating that "to be of the same general character, the items to be supplied must be either identical with those in stock or goods for which dealers in the same line of business would be an obvious source" there is still room for differing interpretation of the "same general character."

An example from the case files should emphasize this point. Specifically, a prospective contractor, a chain dealer, was denied a contract on the basis of failure to stock inventory of the same general character as that required by the contract. The inventory contained differing varieties of chain, but did not include the exact type of chain called for under the contract. In this instance, DCAS in its preaward survey recommended "no award" for failure to meet the Walsh-Healey eligibility requirements.

Upon further investigation, SBA determined that the type of chain at issue was "seasonal" in nature, i.e., heavy chain for use in winter snowstorms. SBA interpreted that the dealer while admittedly not stocking the precise type of chain called for under the contract, still indeed, was a dealer in chain "of the
same general character" as that called for under the contract. In this instance, a CoC was issued and the contractor was awarded the contract.

Determination of whether a bidder proposing to assemble a final product from components parts is an eligible manufacturer must rest on whether the bidder has demonstrated an independent ability, with its plant, equipment and personnel, to perform a significant or substantial portion of the manufacturing operations and efforts required in producing the final product for which the government has contracted. Here, the problem for implementing officials becomes the interpretation of "significant or substantial portion of the manufacturing operations..." What one official might consider to be "significant or substantial" might not be considered as such by another official. A number of such cases were identified during this research.

Determination of whether a newly entering manufacturer has made "prior arrangements and definite commitments" for manufacturing space". Here, the problem for implementing officials becomes the extent to which "prior arrangements and definite commitments" of a legally binding nature have been entered into. Very recently, a case surfaced in which the contracting officer and SBA officials differed in their interpretation of the extent to which prior arrangements and definite commitments had been made. Specifically, in a case before the U.S. District Court
for the District of Rhode Island, it was emphasized that "leases or contingent arrangements [must] be legally binding; only then is there assurance that a bidder is not totally subcontracting out the manufacture of the product." (Federal Contracts Report, v. 46, 1986, p. 949). In this instance, SBA had overturned the contracting officers ruling of nonresponsibility and indicated that several leases, one for office space and the other for manufacturing space, which were on an "as required" basis were sufficient to meet the requirements of the Walsh-Healey Act.

The judge ruled in favor of the contracting officer's interpretation that these contingent "as required" leases were not legally binding, and therefore did not comply with the Act.

Finally, it should be emphasized that, in the informal implementation process, the determination of eligibility under Walsh-Healey often might be considered as a "game". In fact, it was referred to in this light by one industrial specialist during the interviews conducted as part of this study. For example, during the two Federal fiscal years studied for this research, approximately 18% of the firms that first represented themselves as manufacturers" changed that representation to "regular dealer" in order to qualify for eligibility.

A REVIEW OF THE ACT'S BENEFITS

In Federal contracting today, the Walsh-Healey Public Contracts Act, as implemented, serves a purpose that would appear to be
somewhat different than that originally envisioned by its Congressional authors. Specifically, the Act, as implemented today, only acts to ensure that Federal supply contracts are not awarded to "bid brokers." In the implementation process, the deterrence of bid brokering appears to have become an end in itself, rather than a means of ensuring that Federal contracts are awarded only to firms which uphold decent labor standards. This de-linking of bid brokering from the upholding of decent labor standards is reflected in all of the interviews conducted with SBA regional CoC personnel. Specifically, during the course of this research, 16 industrial specialists, 3 attorneys, and 6 regional procurement administrators were interviewed formally (See Table 2-1 for regional listing of interviewees). The U.S. Department of Labor official interviewed during the course of this research also indicated that the regulations are quite effective in ensuring that Federal contracts are not awarded to bid brokers.

All of the officials interviewed emphasized that the protection of labor is not the issue today. Specifically, all of the officials interviewed could not recall having processed a single Walsh-Healey Eligibility Determination where the contract denial was based on contractor failure to uphold decent labor standards (See Table 2-2). In certain cases, there even appeared to be confusion as to the original purpose of the Act. One industrial specialist said it most succinctly: "I never perceived that the
The purpose of the Act was to ensure that the government only award contracts to firms who uphold decent labor standards. I perceived that the Act was to assist the Government in dealing with reputable firms that know their line of business.

Table 2.1. Interviewees By Region, Walsh-Healey Public Contracts Act Study

<table>
<thead>
<tr>
<th>Region</th>
<th>Industrial Specialist</th>
<th>Attorney</th>
<th>Procurement Administrator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boston*</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>New York</td>
<td>3</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Philadelphia</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Atlanta</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Chicago</td>
<td>6</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Dallas</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Kansas City</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Denver</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>San Francisco</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Seattle</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>16</strong></td>
<td><strong>3</strong></td>
<td><strong>6</strong></td>
</tr>
</tbody>
</table>

*Boston Regional Office was visited during proposal stage for this research. Initial interviews were conducted there with the above listed professionals. Given that these interviews were not the same as the formal interviews conducted during the research, they are not included in formal total counts.
Table 2.2 Results of Interview Questions:
Labor Exploitation as a Reason for Walsh-Healey Contract Denials

<table>
<thead>
<tr>
<th>INTERVIEW QUESTIONS</th>
<th>INTERVIEWEES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Industrial Specialist</td>
</tr>
<tr>
<td>From your experience, have any contract denials to small manufacturers been based on their exploitation of labor?</td>
<td></td>
</tr>
<tr>
<td>Response- NO</td>
<td>16</td>
</tr>
<tr>
<td>Response- YES</td>
<td>0</td>
</tr>
</tbody>
</table>

From your experience, have any contract denials to small regular dealers been based on their exploitation of labor?

| Response- NO | 16 | 3 | 6 |
| Response- YES | 0  | 0 | 0 |

In attempting to deter the award of Federal contracts to bid brokers, Walsh-Healey is perceived, by some of the CoC program specialists interviewed, to have a definite strength in Federal contracting today. This strength centers on ensuring that only established, reputable, legitimate firms capable of delivering reliable products are the benefactors of Federal contracts. The Act, as implemented, is described by one industrial specialist to be a "regulator of those people who would like to do business..."
with the Government." Further, the Act, as implemented, is described as ensuring a "degree of integrity or honesty [in Federal contracting] that would not be there without the presence of the law." Also, the Act, as implemented, is described as providing "guidelines for legitimacy--for being the only thing which keeps a desk and phone from winning [government contracts]." Further, the Act, as implemented, is described as ensuring fine scrutiny of prime contractor control over subcontractor performance--an attempt to ensure that the interests of the Government is protected in cases where no legal control over subcontractor performance and/or products exists (See Table 2-3).

Finally, it should be noted that the sections of the implementing regulations which serve this purpose are those sections which define an eligible contractor for purposes of receiving Federal supply contracts regulated by the Walsh-Healey Public Contracts Act.

In the process of deterring "bid brokers" and illegitimate firms from receiving Federal contracts, the Walsh-Healey Public Contracts Act is perceived by many CoC industrial specialists interviewed to protect the interests of legitimate small firms in Federal contracting--firms that have taken the risk to invest in equipment, stock, personnel, etc. Concomitantly, the Act, as
implemented, assists in ensuring that broker sales representatives of larger firms do not receive contracts that should be awarded to legitimate small firms.

Table 2.3. Strengths of Walsh-Healey Public Contracts Act, As Implemented, Perceptions of SBA CoC Officials, 1986

<table>
<thead>
<tr>
<th>CONTENT OF RESPONSES</th>
<th>INTERVIEW QUESTION</th>
<th>Number Providing This Response/Total Number Interviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provides Guidelines for Legitimate Businesses</td>
<td>What do you perceive to be the strengths of the Walsh-Healey Public Contracts Act?</td>
<td>17/25</td>
</tr>
<tr>
<td>Protection of Small Business Interests (from Brokers)</td>
<td></td>
<td>16/25</td>
</tr>
<tr>
<td>Protection of Government Interests</td>
<td></td>
<td>3/25</td>
</tr>
<tr>
<td>Product Delivery Well Defined and Laid Out</td>
<td></td>
<td>10/25</td>
</tr>
</tbody>
</table>
Other CoC personnel were less enthusiastic about the role of Walsh-Healey as a regulator of bid brokers and a protector of small firm interests in Federal contracting (See Table 2-4). One industrial specialist described the Act, as implemented, in the following manner: "The implementation of Walsh-Healey is a game of attempting to determine which slot to fit a contractor into, i.e., regular dealer or manufacturer. The Act doesn’t prevent or deter anything. Bid brokering goes on and will continue to go on with or without Walsh-Healey. It does hurt, however, quite legitimate small firms that get entangled in the regulations. By blocking these firms from Federal contracting, the Government is the ultimate loser." Another specialist stated it like this: "Walsh-Healey is right for the wrong reasons. Quite legitimate firms are deterred or prevented from selling their products to the Government by a set of regulations which don’t appear always to fit the modern business environment. The legislation, as implemented, is out of step with the times."

Another CoC specialist offered: "Perhaps, we should ask ourselves what is wrong with bid brokering? Should the government be deterring this type of contractor? Should this be official policy? If so, perhaps, we should ask what are the benefits and what are the costs?"
Table 2.4. Weaknesses of the Walsh-Healey Public Contracts Act, As Implemented, Perceptions of SBA CoC Officials, 1985-1986

<table>
<thead>
<tr>
<th>CONTENT ANALYSIS OF RESPONSES</th>
<th>INTERVIEW QUESTION</th>
<th>Number Providing This Response/Total Number Interviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulations, Too Strict/Need Updating to Reflect Modern Business Environment/or More Flexibility is Needed</td>
<td>What do you perceive to be the strengths of the Walsh-Healey Public Contracts Act?</td>
<td>18/25</td>
</tr>
<tr>
<td>Doesn't Prevent Anything/An Exercise Only</td>
<td></td>
<td>1/25</td>
</tr>
<tr>
<td>Restricts Competition/Deters Small Legitimate Firms From Selling to Government</td>
<td></td>
<td>15/25</td>
</tr>
<tr>
<td>Effort Not Worth Cost For Such a Small Number of Firms</td>
<td></td>
<td>2/25</td>
</tr>
</tbody>
</table>

Finally, a purposive sample of contracting officers, who have dealt with Walsh-Healey rulings, was drawn to gain their perceptions of the Walsh-Healey Public Contracts Act. Through a telephone interview, the contracting officers were asked questions similar to those asked of the industrial specialists. The
contracting officers contacted were employed by the following agencies: General Service Administration, Defense Logistics Agency, Defense Electronic Supply Center, Naval Supply Center, and U.S. Department of the Army.

With regard to the strengths of Walsh-Healey, the contracting officers offered the following responses: a) prevents sweat shops; b) prevents companies from selling to the government only; c) prevents illegitimate firms from bidding and undercutting legitimate firms. As for the weaknesses of the Act the responses were as follows: a) guidelines are too broad in some instances; and b) the process is too lengthy and thus not efficient.

When asked whether they thought that the implementing regulations have prevented newly established small manufacturers or dealers from selling their supplies to the Federal government all of the respondents answered "no". It should be mentioned that the responding contracting officers stressed the importance, on the part of new firms, that the time be taken to understand the Walsh-Healey regulations.

The contracting officers were then asked if they thought that the implementing regulations should prevent small business men or women who work in their home, and are otherwise capable of fulfilling the terms of an agreement, from obtaining government
contracts. Sixty percent of the responding contracting officers answered "no" and offered that as long as the firm can fulfill the contract, working from the home is acceptable. The forty percent answering "yes" indicated that this was not fair to those contractors who could have potentially set up their business in the home, but complied with the regulations.

As for suggestions on how to improve the regulations, the participating contracting officers offered the following: a) increase the dollar threshold from $10,000; b) shorten the amount of time that it takes to apply the regulations; and c) make certain allowances in the implementing regulations so that they can be more reasonably applied to specific industries, i.e., eliminate the stock on premises requirement for industries such as prefabricated structures and library shelving.
CHAPTER III. SMALL FIRM ENCOUNTERS WITH WALSH-HEALEY REGULATIONS: WHAT ARE THE EXPERIENCES?

OVERVIEW

This chapter provides an examination of small firm encounters with Walsh-Healey regulations both from the perspective of SBA case file data as well as from small firms themselves. Utilizing Walsh-Healey case files from each of the ten regions of the U.S. Small Business Administration, the chapter provides: a) a profile of small suppliers that are denied Walsh-Healey regulated contracts, b) an examination of the origin of Walsh-Healey contract denials to small firms by Federal agency c) a thorough analysis of reasons offered for contract denials, d) a discussion of the specialized types of Walsh-Healey related problems that arise for small firms in the course of the contracting process, and e) a discussion of the costs of the Act both for small suppliers as well as for the Federal government. Finally, the chapter utilizes data from interviews conducted with a purposive sample of small firms denied contracts on the basis of Walsh-Healey to further profile the type of firms denied contracts and to examine the perceived impact of these contract denials on small firm business operations.

IMPLEMENTING REGULATIONS: DIFFICULTIES FOR THE SMALL CONTRACTOR

This research identified a total of 351 small firm contract denials that were referred to the U.S. Small Business Administra-
tion during Fiscal Years 1984 and 1985 for Walsh-Healey eligibility determinations. All of these denials were based on small firm inability to meet the eligibility criteria for either a regular dealer or a manufacturer outlined in the implementing regulations.

Approximately 68% of the 351 referrals were based on failure to meet Walsh-Healey eligibility criteria per se, i.e., the firm did not meet the criteria for either a regular dealer or a manufacturer. The remainder, or approximately 31% of the referrals, was based on both failure to meet Walsh-Healey eligibility criteria as well as failure to meet either the capacity or credit tests of responsibility (See Table 3.1).

Table 3.1 Type of Walsh-Healey Referrals, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>Type of Referral</th>
<th>Number of Firms Referred</th>
</tr>
</thead>
<tbody>
<tr>
<td>Walsh-Healey Only</td>
<td>239</td>
</tr>
<tr>
<td>Dual--Walsh-Healey &amp; Capacity</td>
<td>45</td>
</tr>
<tr>
<td>Dual--Walsh-Healey &amp; Credit</td>
<td>13</td>
</tr>
<tr>
<td>Dual--Walsh-Healey, Capacity, &amp; Credit</td>
<td>52</td>
</tr>
<tr>
<td>Unable To Determine Reason for Referral</td>
<td>2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>351</strong></td>
</tr>
</tbody>
</table>

Note: It should be emphasized that more dual cases probably exist than this research was able to uncover. This results because the cases are logged by their CoC number and any hint of Walsh-Healey eligibility problems are lost in this recording procedure. These were only those cases that the regional offices could locate.
PROFILE OF SMALL FIRMS DENIED CONTRACTS

The Walsh-Healey regulations define the two major categories of supply contractors, as Regular Dealers and Manufacturers. It was possible in only 278 of the 351 Walsh-Healey referrals identified to determine the type of contractor, i.e. regular dealer or manufacturer. Of these 278 cases, however, approximately 78%, or 218 of the cases, were made against firms certified as regular dealers. Firms certified as manufacturers constituted approximately 22% of the referral activity. Table 3.2 below provides a detailed examination of referrals by classification status.

Table 3.2. Classification of Walsh-Healey Contract Denials by Contractor Certification

<table>
<thead>
<tr>
<th>TYPE OF CONTRACTOR</th>
<th>Number of Cases</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular Dealer</td>
<td>218</td>
<td>62%</td>
</tr>
<tr>
<td>Manufacturers, All</td>
<td>60</td>
<td>17%</td>
</tr>
<tr>
<td>Newly Entering</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>47</td>
<td></td>
</tr>
<tr>
<td>Unknown-Missing</td>
<td>73</td>
<td>21%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>351</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Source: U.S. Small Business Administration Regional Office Case Files and CoC Program Monthly Summaries, FY 1984 and 1985. The bulk of the missing data, i.e., 73 cases, results from cases identified in the CoC Program Monthly Summaries that were not found during the regional office visits.
The case file data show that the Walsh-Healey regulations impact most heavily upon firms with 10 or less employees, as would be expected from regulations designed to prevent bid brokering. Over 75% of all of the firms for which employee size was available stated that they employed 10 or less employees (See Table 3-3). Fifty percent (50%) of all of these firms employ 4 or less employees. Bid broker or 1 person firms were found to constitute only 8% of all of the firms for which firm size was available.

It should be emphasized that Walsh-Healey regulations do impact firms with 25 or more employees, however. Slightly more than 12 percent of all firms fell into this category.

Table 3.3. Size of Firms Failing to Meet Walsh-Healey Eligibility Criteria, FY 1984-1985

<table>
<thead>
<tr>
<th>Firm Size</th>
<th>Number of Employees</th>
<th>Number of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All Referrals,</td>
<td>Referrals for</td>
</tr>
<tr>
<td></td>
<td>Including Dual Cases</td>
<td>Walsh-Healey Only</td>
</tr>
<tr>
<td>1</td>
<td>13</td>
<td>10</td>
</tr>
<tr>
<td>2</td>
<td>22</td>
<td>17</td>
</tr>
<tr>
<td>3</td>
<td>31</td>
<td>19</td>
</tr>
<tr>
<td>4</td>
<td>12</td>
<td>7</td>
</tr>
<tr>
<td>5-10</td>
<td>40</td>
<td>21</td>
</tr>
<tr>
<td>11-25</td>
<td>31</td>
<td>11</td>
</tr>
<tr>
<td>26-100</td>
<td>17</td>
<td>11</td>
</tr>
<tr>
<td>100+</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>172*</td>
<td>101</td>
</tr>
</tbody>
</table>

*Firm size was available for only 197 of the 355 Walsh-Healey referrals identified. Among the 197 firms, when firms with more than one referral were eliminated, firm size was available for only 172 distinct firms.
An interesting comparison can be made between the profiles of the regular dealers and the manufacturers denied government supply contracts. The median ages of dealers and manufacturers across all regions are 4.9 years and 6.2 years, respectively.

Yet, in both groups, the percentage of firms that had been established within the two years prior to their referrals was the same, 26.7 percent. In addition to being younger, the regular dealers were also smaller firms in terms of employee size. The regional average of the median number of individuals employed by regular dealers was 4.6, and for manufacturers, 7.8.

In the fiscal realm, no one firm type dominates. Accordingly, regular dealers have a higher sales volume and manufacturers carry more inventory. The median sales for regular dealers was found to be $725,800. This figure is half again as large as the corresponding figure for manufacturers, $520,989. The reverse is true for the inventory figures; the manufacturer inventory value is over six times that for regular dealers, $227,709 and $35,659, respectively.

On another front, the products supplied by the regular dealers and by the manufacturers also varied. Although the Walsh-Healey contractors bid to supply a wide range of goods, from helicopter rotors to office supplies, each firm type had concentrations of product codes which were bid for more frequently (See Table 3.4).
Table 3.4 Walsh-Healey Referrals by Type of Product Supplied, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>PRODUCT SUPPLY GROUP</th>
<th>MANUFACTURER</th>
<th>REGULAR DEALER</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>25--Vehicular Equipment Components</td>
<td>3</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>28--Engines, Turbines, &amp; Components</td>
<td>6</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>34--Metalworking Machinery</td>
<td>0</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>48--Valves</td>
<td>1</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>54--Prefabricated Structures and Scaffolding</td>
<td>5</td>
<td>9</td>
<td>14</td>
</tr>
<tr>
<td>59--Electrical/Electronic Equipment Components</td>
<td>6</td>
<td>11</td>
<td>17</td>
</tr>
<tr>
<td>61--Electric Wire and Power Distribution Equipment</td>
<td>2</td>
<td>14</td>
<td>16</td>
</tr>
<tr>
<td>66--Instruments and Laboratory Equipment</td>
<td>1</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>68--Chemical &amp; Chemical Products</td>
<td>0</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>70--General Purpose ADP Equipment, Software, Supplies, and Support Equipment</td>
<td>1</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>71--Furniture</td>
<td>0</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>73--Food Preparation &amp; Serving Equipment</td>
<td>0</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>75--Office Supplies &amp; Devices</td>
<td>2</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>79--Cleaning Equipment and Supplies</td>
<td>1</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>84--Clothing, Individual Equipment &amp; Insignia</td>
<td>2</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>89--Subsistence (Food, Beverages, Tobacco)</td>
<td>1</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>91--Fuels, Lubricant Oils, and Waxes</td>
<td>2</td>
<td>17</td>
<td>19</td>
</tr>
<tr>
<td>95--Metal Bars, Sheets and Shapes, Iron and Steel Plates</td>
<td>5</td>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>99--Miscellaneous Signs, Advertising, and I.D. Plates</td>
<td>0</td>
<td>6</td>
<td>6</td>
</tr>
</tbody>
</table>

*Most frequent product referrals only.
Manufacturer referrals were most often for firms planning to make and supply engine turbines and components and electrical/electronic equipment components. A number of manufacturer referrals also were for making and supplying prefabricated structures. Regular Dealer referrals, on the other hand, were most heavily in four categories:

a) Fuels, Lubricants, Oils and Waxes. The most common subcategories were Fuel Oils and Greases.

b) Electric Wire and Power Distribution Equipment

c) Electrical or Electronic Equipment Components.

d) Food Preparation and Serving Equipment

Overall then, the profile of a typical firm found in the Walsh-Healey case files would contain the following characteristics:

- The firm is a Regular Dealer.

- The firm was established just over five years prior to the date of the Walsh-Healey referral.

- The firm employs approximately six workers.

- The firm's annual sales reach $613,400.

- The firm's inventory is valued at $131,700.

- The firm deals in fuel oils.
Origin of Contract Denials by Federal Agency. Finally, a comparison of the Federal agency contract denials by firm type is provided in Table 3.5. Specifically, this table summarizes the frequency of Walsh-Healey contract denials made by the contracting officers of Federal agencies involved in supply contracting during FY84 and FY85.

Note that the Regular Dealer order of frequency for the procuring agencies parallels that in the Combined column. For Manufacturers, however, the Army was the most frequent procuring agency with a significantly higher percentage than that found with the regular dealers, or in the group as a whole. It is not surprising then that over 75% of all the referrals for manufacturers came from defense related agencies (DLA, Army, Navy, Air Force). The corresponding figure for regular dealers and defense referrals is 65%, or approximately two-thirds of all the dealer cases.

Reasons for Contract Denials. The small suppliers examined during the course of this research were denied contracts because of their failure to meet one, several, or all of the criteria for either "regular dealer" and/or "manufacturer" eligibility outlined in the Walsh-Healey implementing regulations. This section provides a profile of the reasons offered for their contract denials. Many factors affect the reasons why a firm's bid is denied, and often the reason is a combination of those factors rather than one clear cut tangible regulatory response.
Tables 3.6a and 3.6b provides a list of regulatory-based reasons for denial applied to the cases reviewed in the regions.

Table 3.5 Walsh-Healey Contract Denials
By Federal Agency, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th></th>
<th>Regular Dealers</th>
<th>Manufacturers</th>
<th>Combined Dealers and Manufacturers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>DLAs: 41.0% (82)</td>
<td>ARMY: 33.0% (19)</td>
<td>DLA: 37.0% (95)</td>
</tr>
<tr>
<td></td>
<td>GSAs: 32.0% (64)</td>
<td>DLA: 22.0% (13)</td>
<td>GSA: 29.0% (76)</td>
</tr>
<tr>
<td></td>
<td>ARMY: 8.0% (19)</td>
<td>GSA: 21.0% (12)</td>
<td>ARMY: 15.0% (38)</td>
</tr>
<tr>
<td></td>
<td>NAVY: 8.0% (16)</td>
<td>NAVY: 12.0% (7)</td>
<td>NAVY: 9.0% (23)</td>
</tr>
<tr>
<td></td>
<td>USAFs: 7.5% (13)</td>
<td>USAF: 10.0% (6)</td>
<td>USAF: 7.0% (19)</td>
</tr>
<tr>
<td></td>
<td>INTERIOR: 2.0% (3)</td>
<td>DOT: 2.0% (1)</td>
<td>INTERIOR: 1.0% (3)</td>
</tr>
<tr>
<td></td>
<td>VA: 0.5% (1)</td>
<td>DOT: 0.5% (1)</td>
<td>VA: 0.5% (1)</td>
</tr>
<tr>
<td></td>
<td>USDA: 0.5% (1)</td>
<td>USDA: 0.5% (1)</td>
<td>USDA: 0.5% (1)</td>
</tr>
<tr>
<td></td>
<td>MCORPS: 0.5% (1)</td>
<td>MCORPS: 0.5% (1)</td>
<td>dotsicrobial</td>
</tr>
<tr>
<td></td>
<td>TOTAL 100.0% (200)</td>
<td>100.0% (58)</td>
<td>100.0% (258)</td>
</tr>
</tbody>
</table>

NOTE: ( ) Total Number of Referrals for Which Procuring Agency Was Known.

LEGEND
VA= Veterans' Administration
DLA= Defense Logistics Agency
DOT= Department of Transportation
GSA= General Services Administration
USDA= United States Department of Agriculture
INTERIOR= Department of Interior
USAF= U.S. Air Force
### Table 3.6a Regulatory Based Reasons for Regular Dealer Denials

<table>
<thead>
<tr>
<th>Category of Denial</th>
<th>Regulatory Based Reason for Contract Denials</th>
</tr>
</thead>
<tbody>
<tr>
<td>REGULAR DEALER</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>R1: The dealer has no established space, which he maintains on a continuing basis to store his stock.</td>
</tr>
<tr>
<td></td>
<td>R2: The dealer does not maintain a true inventory from which sales are made.</td>
</tr>
<tr>
<td></td>
<td>R3: The dealer does not stock goods of the same general character as those required by the contract bid for.</td>
</tr>
<tr>
<td></td>
<td>R4: The dealer does not regularly make sales from his stock.</td>
</tr>
<tr>
<td>Commercial Sales</td>
<td>R5: The dealer does not sell a significant portion of supplies to the general public.</td>
</tr>
<tr>
<td>Viability</td>
<td>R6: The dealer is not an established, on-going concern.</td>
</tr>
<tr>
<td></td>
<td>R7: Other, includes protest cases, inappropriate referrals, etc.</td>
</tr>
</tbody>
</table>
Table 3.6b Regulatory Based Reasons for Manufacturer Contract Denials

<table>
<thead>
<tr>
<th>MANUFACTURER</th>
<th>Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>M1: The bidder is not an established manufacturer of the goods sought by the government; the bidder does not own, operate, or maintain a factory or establishment that produces on the premises the materials, supplies, articles, or equipment required under the contract and of the general character described by the specifications.</td>
<td></td>
</tr>
<tr>
<td>M3: The bidder intends to subcontract a significant portion of the work; the bidder has not demonstrated an independent ability with its plant, equipment and personnel, to perform a significant or substantial portion of the manufacturing operations and efforts required in producing the final product for which the government contracted (manufacturer-assembler).</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NEW MANUFACTURER</th>
<th>Commitments</th>
</tr>
</thead>
<tbody>
<tr>
<td>M2: The bidder has made no prior arrangements for the facilities or personnel required to comply with the contract.</td>
<td></td>
</tr>
<tr>
<td>M4: Other, includes protest cases and inappropriate referrals</td>
<td></td>
</tr>
</tbody>
</table>

The great majority of the known denials for manufacturers, 70%, fell into the M1 category (See Table 3.7). The firms referred for not being established manufacturers of the goods sought by
the government can be categorized into three groups. The divisions are:

1) Firms that are newly entering manufacturers; a distinction held by nearly 27% of all the manufacturers referred for Walsh-Healey violations.

2) Firms that are established manufacturers for other goods and are trying to expand their line of products.

3) Firms acting as agents/middle men that intend to subcontract the work to other manufacturers.

In addition to the firms cited under denial reason, M1, newly entering firms without prior arrangements, M2, accounted for 10.9% of the referrals, and manufacturer-assemblers, M3, accounted for 15.6% of the case denials.

Table 3.7 Reasons for Manufacturer Contract Denials FYs 1984-1985

<table>
<thead>
<tr>
<th>Reason for Denial</th>
<th>Number of Referrals</th>
<th>Dollar Value of Referrals</th>
</tr>
</thead>
<tbody>
<tr>
<td>M1</td>
<td>31</td>
<td>$10,081,724</td>
</tr>
<tr>
<td>M2</td>
<td>7</td>
<td>$1,358,242</td>
</tr>
<tr>
<td>M3</td>
<td>10</td>
<td>$7,392,976</td>
</tr>
<tr>
<td>M4</td>
<td>8</td>
<td>$1,405,614</td>
</tr>
<tr>
<td>UTD*</td>
<td>4</td>
<td>$678,994</td>
</tr>
<tr>
<td>Total</td>
<td>60</td>
<td>$20,917,550</td>
</tr>
</tbody>
</table>

*Unable to Determine

Regular dealer denials are much more complex, not only because the denial reasons are more numerous, but also because those reasons are not mutually exclusive. For example, four of the
reasons are inventory or stock centered and two of those mention sales from that inventory/stock. The following table shows the frequency of the denial reasons in the referral process. It should be noted that 77% of the denials were inventory related, i.e., R1, R2, R3, and R4. Within the inventory-related denials, 51% of the contracts were denied because of failure to maintain a true inventory from which sales are made. Finally, it should be emphasized that the failure of firms to sell to the general public, i.e., sales to other than Federal, state, or local governments, figured in at least 29% of all of the denials. It was the singular reason in only 8% of the denials, however.

Table 3.8. Reason for Contract Denials, Regular Dealers, Fiscal Year 1984-1985

<table>
<thead>
<tr>
<th>Reason for Denial</th>
<th>Number of Referrals*</th>
<th>Percentage of Referrals**</th>
</tr>
</thead>
<tbody>
<tr>
<td>R1</td>
<td>52</td>
<td>28.0%</td>
</tr>
<tr>
<td>R2</td>
<td>73</td>
<td>39.0%</td>
</tr>
<tr>
<td>R3</td>
<td>31</td>
<td>17.0%</td>
</tr>
<tr>
<td>R4</td>
<td>10</td>
<td>5.0%</td>
</tr>
<tr>
<td>R5</td>
<td>53</td>
<td>29.0%</td>
</tr>
<tr>
<td>R6</td>
<td>2</td>
<td>1.0%</td>
</tr>
<tr>
<td>R7</td>
<td>27</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

*The reason for contract denial was available in a total of 185 of the regular dealer referrals examined. The numbers will not add to 185 because the reasons are not mutually exclusive; often referrals cited two reasons for contract denials; in others, three reasons were cited.

**These percentages are based on the 185 cases for which the reason for contract denial was known; the percentages will not add to 100% because the reasons are not mutually exclusive.
When the dollar value of the regular dealer contract denials is examined in terms of the reason offered for the denial, it becomes evident that inventory-related reasons for contract denial are the most critical (See Table 3.9).

Table 3.9
Reasons Offered for Regular Dealer Contract Denials, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>Reason Offered for Contract Denial</th>
<th>Total Dollar Value of Contract Denials</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory Related (R1-R5)</td>
<td>$34,328,685</td>
</tr>
<tr>
<td>No Sales to the General Public</td>
<td></td>
</tr>
<tr>
<td>--Cases Where This Was the Only Issue</td>
<td>$ 842,042</td>
</tr>
<tr>
<td>--Cases Where This Was an Issue along With Another Reason, i.e., inventory</td>
<td>$10,592,672</td>
</tr>
<tr>
<td>Capacity (R6)</td>
<td>96,230</td>
</tr>
<tr>
<td>Other, i.e., Protests, etc. (R7)</td>
<td>$52,862,335*</td>
</tr>
</tbody>
</table>

*This amount includes one (1) contract for approximately $47 million involved in protest dispute.

Following is a list of examples, not all inclusive, demonstrating common reasons for the different contract denials.

R1: The dealer worked out of his home or only rented a sales or front office.

R2: The dealer may have special inventory items which can not be stockpiled, i.e. custom made furniture, extremely large items.

R3: There were seldom secondary factors affecting this reason. It often became a judgement call as to whether the product in the bid was related closely enough to the product normally handled by the firm.
R4: This reason is often associated with R2, for firms whose goods are specialized or become quickly outdated.

R5: This denial reason presents the greatest problem in terms of supplementary factors. An analysis of the products supplied by firms receiving an R5 contract denial presented an unsolved dilemma. Many of the firms cited for this violation specialize in products which the general public has little use for.

R6: This is a very infrequently used contract denial reason.

The R7, "other" category, includes a wide range of reasons for contract denials, i.e. the presence of third party protests. Also, at this point, special mention should be made of the regular dealer in petroleum products, particularly given their numbers in the referral process. Reasons offered for denial of contracts from these firms are two-fold, and usually, both reasons were cited: a) failure to own, operate, and maintain petroleum distribution equipment, and b) failure to possess "a store, warehouse, or other place of business in which petroleum products of the general character described by the specifications and required under the contract are bought for the account of such person and sold to the public in the usual course of business." (Title 41, Part 40-201.101(i)(vi)).

**SMALL SUPPLIERS UNABLE TO MEET WALSH-HEALEY ELIGIBILITY CRITERIA**

The Walsh-Healey regulations, as currently designed and implemented, are likely to deter the following types of small firms from receiving Federal supply contracts:

---Distributors offering custom-designed, specialty products or unusual items;
--Suppliers offering high technology products and installing custom-designed high technology systems;

--Distributors either offering products of limited utility to the commercial marketplace or targeting their major marketing efforts toward the Federal government;

--Manufacturing representatives who sell the products of either small or large manufacturing establishments.

Additionally, the implementing regulations are likely to deter small distributors who only recently have established their businesses or who only recently have engaged in product diversification. Each of these types of suppliers are described further in the following sections.

Suppliers of Custom-Designed, Specialty Products. A number of the firms examined during the course of this research were suppliers of custom designed or specialty products. These firms were denied contracts because of their failure to stock inventory. Examples of the types of custom-designed products offered included the following: a) library shelving; b) x-ray equipment and supplies; c) language laboratories; d) modular office units; e) video-equipped mobile units; and f) specialty advertising products, i.e., ashtrays, t-shirts, pens, etc. It should be emphasized that the latter type supplier was granted a special administrative exemption from Walsh-Healey regulations that became effective in 1985.

Suppliers Offering High Technology Products. Distributors of computer hardware and peripherals were found among the firms
denied contracts on the basis of their failure to stock inventory. The fear of product obsolescence in a period of rapidly advancing technology was cited as the reason for failure to warehouse a large product inventory.

Suppliers Providing and Installing Custom-Designed High Technology Systems. Another type of firm also likely to be denied contracts on the basis of Walsh-Healey is the small supplier that custom designs and assembles high technology systems using off-the-shelf components. Several examples should suffice:

--Firm A attempted to sell two dual port disk drives and a disk controller, and install these drives and controller into an already existing Factory Automated Communication System. The firm in question had served as the prime contractor of this Factory Automated Communication System. In this instance, the firm was denied the supply contract because it failed to meet the eligibility criteria for manufacturer. Specifically, although the firm manufactured other computer equipment, it did not manufacture the disk drives "and to a lesser extent, the disk controller required for the solicitation...Likewise, the minimal manufacturing work performed [i.e., the installation and wiring of required components], albeit vitally important to make the purchased components actually operate as a system, can't be legally considered "substantial and significant fabrication or production of desired product under the assembly definition on the basis of all the circumstances since the assembly of the major components is vitally unaffected."

--Firm B attempted to sell two custom conveyor systems for hazardous material handling. The Request for Proposal (RFP) required the contractor
to "...furnish all labor, materials, and equipment for complete installation of one (1) conveyer system...prepare 'preliminary engineering layout and equipment drawings and descriptive data'...prepare and furnish maintenance manuals, operating manuals, as-built and layout drawings, short form provision and parts list, supplementary provisioning, and training manual, all prepared specifically for this contract for these two custom conveyer systems. The solicitation thus requires the contractor to design these custom conveyer systems, to furnish the components of the systems, and to perform complete installation of the system on-site." In this instance, the contractor failed to meet either the regular dealer or manufacturer eligibility requirements of Walsh-Healey. The failure to meet the regular dealer requirement stemmed from the contractor's lack of inventory of the off-the-shelf components; the failure to meet the manufacturer requirement stemmed from the fact that the contractor was only to engage in the assembly and installation into a system of the off-the-shelf components, and not manufacturer these components, per se. This type of assembly and installation does not meet the manufacturer requirements as defined in the implementing regulations.

Distributors Offering Products of Limited Utility to the Commercial Marketplace or Targeting Their Marketing Efforts Toward the Federal Government. Firms that offer products purchased almost exclusively by the Federal government or firms that prefer to market their products to the Federal government are often denied Federal supply contracts on the basis of Walsh-Healey regulations. These denials stem from the failure of these firms to meet the regular dealer eligibility requirement that sales must be made regularly to the public, i.e., non-Federal, state, or local governments. The ten most frequent product code categories for these types of firms are as follows: 1) Engines,

Any small supplier that has targeted the Federal marketplace as the exclusive or major buyer of its products may be likely to have its bid rejected on the basis of failure to meet this requirement of the Walsh-Healey implementing regulations.

Manufacturer Representatives. Independent business persons who serve as manufacturing representatives also often are denied contracts on the basis of Walsh-Healey regulations. These contracts denials generally are based on their failure to stock inventory and make sales from inventory in the regular course of business.

Recently Established Distributorships. The Walsh-Healey implementing regulations are particularly harsh for newly or recently established distributorships. Specifically, the eligibility criteria for regular dealers include no special arrangements or provisions for the newly entering firm. This is in particular contrast to the implementing regulations for manufacturers which do include special provisions for the newly entering manufacturer. Of particular difficulty for the newly established
dealership is the requirement to demonstrate a sufficient stock of inventory. In the case of these new firms, it is simply not sufficient to demonstrate that commitments to obtain an inventory have been arranged. The difficulty for the newly entering firm also is demonstrated for the regular dealer in petroleum products. Here, a small firm that "doesn't own, operate or maintain a store or warehouse in which petroleum products of the same general character described by the specifications are sold to the public in the usual course of business and doesn't maintain petroleum distribution equipment" is subject to contract denial under the Walsh-Healey regulations. Evidence of negotiation to lease space for use in connection with product sales and activities is simply insufficient to warrant a contract award.

**Suppliers Undergoing Product Diversification.** Also apt to be caught in Walsh-Healey implementing regulations are those firms that are undergoing or would like to undergo product diversification. Such firms often cannot meet the regular dealer eligibility requirement that the goods stocked must be of the same general character as those required by the contract.

**SPECIAL PROBLEMS IN THE WALSH-HEALEY IMPLEMENTATION PROCESS**

A number of special problems in the Walsh-Healey implementation process were highlighted through the analysis of Walsh-Healey case file data. Fortunately, these problems appear minor and can in no way be considered abusive on a broad scale:
Of particular interest are three changes. The first change is that which has occurred in the technology of distribution. This change has radically altered the role of the distributor or "regular dealer" as defined by the Walsh-Healey implementing regulations. The second change centers on the growth of the Federal government and the concomitant rise of firms that cater specifically to the needs of government. This change brings into serious question the refusal of Walsh-Healey regulated contracts to deal with firms that have no sales to the general public. The third change, which has been discussed earlier, centers on the creation of a "hybrid" supplier of high technology systems --a supplier which can not meet the eligibility criteria for either the manufacturer or regular dealer as outlined in the Walsh-Healey implementing regulations.

Changes in the Technology of Distribution. Distribution in the modern economy includes all steps that involve "the transportation of goods from the point of original or intermediate production to the place of sale." It includes "the storage of goods until they are needed and the merchandising, display advertising of goods, and their actual sale or transfer into the possession of the ultimate buyer..."


26 Ibid.
The trend in distribution that has occurred and is likely to continue into the foreseeable future has focused on eliminating or reducing the physical handling and intermediate storage of goods from the manufacturer to the consumer. Increasingly, manufacturers have performed and are performing "a time and place utility function through strategically located warehouses that supply mass marketers with products at top delivery speeds." This trend in the system of distribution has resulted from a number of factors, the most notable being cost consciousness and developments in modern transportation, telecommunications, and data processing.

The physical movement of goods and their storage as inventory until the point of ultimate sale is costly for all types of businesses, but particularly for the small business with limited investment capital and cash flow problems. The costs associated with inventory storage result not only from the tie up of investment capital and outlays for warehousing space, but also from the potential obsolescence of goods—a problem encountered more frequently in an economy undergoing rapid technological advancement.

In view of these costs, all businesses, including small businesses, have often found it more economical to a) reduce the number of times that goods are physically moved from one location to the

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27 Ibid.
other; and b) reduce the amount of goods physically stored as inventory. To accomplish the former, modern distributors often have goods "drop shipped" directly from the manufacturer to the consumer—thus eliminating several physical handling steps, i.e. delivery of goods to the distributor and then delivery of goods to the consumer. This method of drop shipping also results in a reduction of inventory, thus eliminating the costs associated with storing and maintaining this inventory.

The practice of drop shipping, thereby reducing physical handling and storage costs, has been enhanced by several developments in the modern economy. First, has been the rise of modern telecommunications which have enhanced the linkage through computers of distributors with manufacturers. Second, has been the development of a streamlined transportation system which has contributed to the rapid delivery of goods to the consumer. Today, as a result of the computer and modern air and highway networks, within a matter of 48 or 72 hours, an order for goods from the distributor can be processed and speeded by the manufacturer to the point of ultimate delivery, thus eliminating the requirement for intermediate inventory storage.

In many cases, these developments have resulted either in eliminating wholesalers and certain types of distributors—the modern day "regular dealers" or in forcing them into operations
"different from the classical one which has been in existence since the advent of the industrial revolution." 28

Firms engaging in such operations often have the appearance of, or are, in fact, quite legitimate "bid brokers" who offer reputable products under supply arrangements with producers or manufacturers. Firms of this type are often caught up in Walsh-Healey regulations as the examples in the following sections demonstrate; the names of these firms will remain confidential for reporting purposes.

Firm #1. Dealer. Exterior Prefabricated Structures. This firm was denied a contract on the basis of a GSA plant facility report which indicated that the company did not stock goods of the same general character as those required by the procurement. A letter from the firm's Vice President in defense of their failure to stock inventory emphasized that "the size, type, and dimensions of the market we serve is such that it is not cost effective or beneficial to our customers to stock the various buildings and steel building materials in our California or Hawaiian locations. As a dealer for several building materials manufacturers in many locations, we can provide the best and most cost effective product to our customers by not moving merchandise to California and then on to the building site. Rather, we place the customer order with the closest supplier (manufacturer) that can best fill customers request and deliver directly to the customer from the manufacturer, thereby reducing the cost of the order considerably...If we are to be successful in today's highly competitive market, it is imperative that we endeavor to keep the cost of materials and shipment at realistic levels. This can only be done as outlined above."

The Vice President in another letter states "First and foremost, the very premise upon which [our] business venture was built is threatened by the main requirement of the Walsh-Healey regulations...[that] states that the bidder must have 'an establishment

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28 Ibid.
or leased or assigned space in which it regularly maintains a stock of goods in which it claims to be a dealer; if the space is in a public warehouse it must be maintained on a continuing, and not on a demand basis.'"

The Vice President continues by saying that he will contain his remarks only to the above excerpt. He goes on to say that "any sincere local businessman desiring to be successful in his local geographical area, must attempt to maintain some type of storage facility for his wares. Some wares are easier stored locally than others. The example used [is] 'glasses'. A small somewhat perishable item which requires relatively small areas for even some of the largest sizes of its kind. One can visualize the capability of displaying and storing hundreds of designs, shapes, and sizes in a small warehouse/showroom facility. Perhaps, 4,000 square feet would create a medium size facility for that purpose. Comparing this to wooden and related construction materials, we find that for this type of local business, the medium sized facility would have to cover perhaps two or three acres, and all this to store and display partially processed raw materials. If we compare this still further to a local medium sized steel frame building facility, in order to display and store complete lines of merchandise, this facility will have to span as much as ten jam packed acres of finished building materials of many different sizes, shapes, and painted items from several different manufacturers. This is obviously not realistic in today's business atmosphere if a business is to remain competitive. ... Today's business methods utilize the efficiency and productivity of American ingenuity. Hence, we are able to convert raw materials into finished products and move these directly to the user location quicker and more cost effectively than can other independent nations. In closing I would like to propose that the legislative process again re-evaluate the original intent of chapter 50, Section 206.53, Public Contracts, Department of Labor. It is also herein suggested that perhaps the current law which has disqualified so many dealers is now obsolete and should be made to conform to current efficient business practices so as to reduce government spending which is a top issue in today's business, as you know."

Firm #2. Dealer. Laboratory Apparatus and Related Equipment. In a letter to SBA officials, the firm President states that "during our negotiations with GSA, we made a point to clarify that while we have not had the need to inventory each and every item covered by this contract, we nevertheless are engaged in the distribution of laboratory equipment, supplies, and chemicals...we do have and have had a cooperative business relationship which offers us the opportunity to utilize the manufacturer's on hand inventory to make drop shipments directly to our customers."
Firm #3. Dealer. ADP Equipment. Letter from the President to GSA stated "I believe that being excluded from a GSA schedule contract because we do not carry an extensive inventory is unwarranted because of the nature of the products we offer and the fact that the present economic environment is not conducive to maintaining a large inventory. We maintain a flow through level of inventory by which we mean that we stock the quantity and mix of products which we project will be sold over the next 30-45 days...Our products are compatible with a wide range of computer systems from the personal computer to the VAX type mainframe computer. It is impossible for a company of our size to maintain an inventory of the complete product mix. We project our requirements for a 30-45 day period and place our orders for stock based upon those projections. In those items we do not stock, we obtain them from the manufacturer and have them drop shipped to the customer within 30 days.

Another consideration which is very important to a small business is the cost of maintaining inventory. A small business has to borrow money at best four percent above the prime rate. Hence, the cost of financing inventory is in the range of 16-18%. In addition, we have to pay property tax to the State of Maryland on our inventory. Also, we have to discount our products to place them on a GSA schedule and we must pay all shipping charges. Consequently, a small business inventory must be handled very carefully if one is to survive. We feel that our present system is a reasonable compromise between providing timely delivery of products to our customers and the economic constrains of maintaining competitive pricing."

Firm #4. Dealer. Petroleum Products. This firm—a one person operation—was denied a contract on the basis of Walsh—Healey because of the failure to maintain an inventory and the failure to possess petroleum product distribution equipment. At the time of the bid and contract denial, this firm had a supplier relationship with a large manufacturer of lubricants. The President in a letter to the Defense Logistics Agency states that the arrangement that he has with the manufacturer "does not include the need for me to stock inventory, other than samples. The niche markets, including the military, are mostly out of state and [the manufacturer] ships direct. The orders I receive have always been delivered on time and of the highest quality."

Growth of Government and the Specialization of Firms Dealing Exclusively with Government. In 1961 when the contractor eligibility regulations became administrative law, the Federal
government administered a Federal budget considerably less than that which exists today. This vastly expanded Federal government has been accompanied by the development of specialized divisions within existing firms and specialized service and supply industries that cater specifically to the needs of the Federal buyer. Contributing to these developments has been a Federal contracting system that is unique and that requires a degree of specialization on the part of companies that wish to market their products within the system. Today, it is quite common to encounter companies with Federal Marketing Divisions or companies that openly state that the exclusive buyer of their product or service is the Federal government. Add to these developments, the expansion of the Federal sector concerned with the Nation's defense and one finds that purchases made by this sector often have no public market sector utility.

Caught in the quagmire of Walsh-Healey regulations are small firms that often fit the above description. Firms that have surveyed market demand and have concluded that the Federal government, by far, is the best, most profitable market for their products. The following example of a letter should help emphasize this point:

A small firm was denied a contract because of its failure to make regular sales to the public and its failure to maintain an adequate inventory. The firm is a regular dealer in film products, including microfilm. In a letter protesting the contract denial, the firm President stated "it is true that the bulk of [our] sales are to government agencies. This is where
the market has been up to this point. As with any new business, we have evaluated overall market potential in an effort to target the largest number of potential clients...[our company] was created solely to market film sales to the Government, which it has successfully performed for the past two years...The fact that the bulk of current film sales are to Government agencies is a reflection more of what constitutes the principal marketplace for unprocessed microfilm than our reluctance to pursue a commercial market base... In summary, microfilm, is a product procured by the Federal, state, and local governments in quantity, but not used by the general public in the same manner."

SUBSEQUENT DEVELOPMENTS AFFECTING THE LAW ITSELF--FAIR LABOR STANDARDS LEGISLATION

In 1936, when the Walsh-Healey Public Contracts Act was adopted, similar labor legislation was scarce. The Davis-Bacon Act of 1931 provided minimum wage protection for construction workers and the National Industrial Recovery Act had, just one year earlier, been deemed unconstitutional. Today, however, there are numerous pieces of legislation at both the Federal and State levels, containing provisions for fair labor standards.

It is interesting to compare Walsh-Healey to the Davis-Bacon Act. In a 1979 report the General Accounting Office termed Davis-Bacon out of date, and called for its repeal. The two acts share the following characteristics:

a) Both were born in attempts to keep the government from supporting contractors who depressed local economies and wages: Walsh-Healey with sweat shops and Davis-Bacon through the use of itinerant and unskilled laborers who were brought in from outside the community and paid lower than the prevailing wages.

b) Both were based on public contracting although they concentrated on different industries: supply and construction.
c) Both provided for minimum wage protection through prevailing wage determinations made by the Department of Labor.

It is this former facet of the two laws which is problematic and largely forms the basis for the GAO's call for a repeal of Davis-Bacon. The construction wage determinations made by the Department of Labor were found to be inflationary, thus throwing off the prevailing wage scales and increasing the overall costs to the government. In the case of Walsh-Healey, the Department of Labor has failed to make a prevailing wage determination since 1964, after issuing 121 such determinations between 1937 and 1964.\(^{29}\) Due to the drastically changed economic conditions since the depression and the standards set by other pieces of fair labor legislation, the Commission on Government Procurement Study Group 2 determined that the elimination of the wage determinations and subsequent adoption of the minimum wage levels set by the Fair Labor Standards Act of 1938 have had no adverse affect on government supply contracting.

Several other fair labor laws have an either overlapping or supplementary relationship to Walsh-Healey. The Service Contracts Act of 1965 provides for similar labor protection standards, of minimum wage and safe working conditions, as Walsh-Healey. The Service Contracts Act states that its provisions shall not apply

\(^{29}\) The Davis-Bacon Act Should be Repealed. General Accounting Office. 1979, p.25.
to contracts whose work is also covered by Walsh-Healey. Federal
Procurement Data Center figures indicate that this overlap
occurs in 14.6 percent of all the Federal contract dollars
awarded to supply contractors in FY84 and FY85.

The Contract Work Hours and Safety Standards Act of 1962 does not
apply to a specific industry as do the laws previously discussed.
Instead it covers all laborers and mechanics working on contracts
financed in some part by the Federal government. The law itself
codifies a long series of "Eight-hour" laws which have been
passed since 1936. The Act requires that contractors use the
standards of an eight-hour day and a forty hour week, with over-
time compensation for those workers who exceed these limits.

Breaking the mold of using government contracts as a basis for
covering employees, the Williams-Steiger Occupation Safety and
Health Act had more universal applications. The act encourages
all businesses to reduce the number of safety and health hazards
on their premises, as well as mandated the Secretary of Labor
to set mandatory safety and health standards in order to "pre-
serve our human resources."

Finally, the most comprehensive piece of labor legislation to
date is the Fair Labor Standards Act of 1938, also known as the
Wages and Hours Law. The provisions of the Act cover all workers
of businesses engaged in interstate commerce, and those producing
goods for interstate trade. Its purpose was to eliminate "labor
conditions detrimental to the maintenance of the minimum standards of living necessary for health, efficiency and well being of workers. The Fair Labor Standards Act, in a scope of "substantial universality" contains provisions for fixed minimum wage standards, overtime compensation, mandatory record keeping, and child labor standards.

When considering the four labor related subsections in 41 U.S.C. 35, one finds a thread of similarity between the Walsh-Healey provisions and those of the other laws. This thread of similarity occurs often enough that a web of fair labor standards legislation has been created. While the web does not completely overlap with all sections of the Walsh-Healey Act, it would provide substantial support to supply contractors if the Walsh-Healey provisions did not exist (See Table 4.1 on the following page).

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Table 4.1 Legislation Designed to Protect Labor

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SUBSEQUENT DEVELOPMENTS AFFECTING THE LAW ITSELF—IMPROVEMENTS IN THE FEDERAL ACQUISITION PROCESS

Regulations governing Federal acquisition are quite sophisticated today in contrast to 1936, the year of the final debate and passage of the Walsh-Healey Public Contracts Act. Specifically, in 1936, the Armed Services Procurement Act—the legislation "paving the way for uniformity of procedure and practice among the military services, including the new Air Force"—was still 12 years into the future. The Federal Property and Administrative Services Act of 1949—the legislation providing the basic statutory authority for procurement and contracting for civilian executive agencies was 13 years into the future.
The State of Federal Acquisition in 1936. As indicated earlier, at the time of the final debate surrounding the Walsh-Healey Public Contracts Act, Congress was concerned about how to ensure that the Government deal only with responsible contractors, and in the process exclude from the purchasing process, bid brokers. In 1936, responsibility for supply contractors was defined only by their ability to put up a performance bond. The search led to the incorporation of the terms, "regular dealer" and "manufacturer" into the Act in an attempt to ensure that only legitimate contractors capable of delivering quality products that would provide decent working conditions for their employees were the benefactors of Federal supply contracts.

The Current State of Federal Acquisition. Today, a comprehensive set of regulations—the Federal Acquisition Regulations (FAR)—governs the Federal contracting process. The FAR, which resulted from Executive Order 12352, provides for one "uniform, simplified regulation governing the acquisition of supplies and services with appropriated funds for all federal executive agencies both civil and military." Specifically, the FAR replaced the Federal Procurement Regulations (FPR) which governed civilian agency procurement and the Defense Acquisition Regulation (DAR) which governed military procurement. It also replaced

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other agency procurement regulations although agencies "are authorized to implement or supplement the FAR in a limited way and under restrictive conditions." 33

The FAR: Determining Prospective Prime Contractor Responsibility. Comprising Title 48 of the Code of Federal Regulations, the FAR covers all aspects of acquiring goods and services including "procedures for determining whether prospective contractors and subcontractors are responsible." As outlined by the FAR, a prospective contractor, in order to be determined "responsible" must possess the following characteristics:

--have adequate financial resources to perform a contract or have the ability to obtain these resources;

--be able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and governmental business commitments;

--have a satisfactory record of integrity and business ethics;

--have the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain them (including, as appropriate, such elements as production control procedures, property control systems, and quality assurance measures applicable to materials to be produced or services to be performed by the prospective contractor and subcontractors);

--have the necessary production, construction, and technical equipment and facilities, or the ability to obtain them; and

33 Ibid.
be otherwise qualified and eligible to receive an award under applicable laws and regulations (FAR, Part 9.104-1).

The FAR: Determining Prospective Subcontractor Responsibility. Of particular interest to the Federal government when dealing with firms that are perceived as "bid brokers," or firms that subcontract a substantial portion of the work, is the ability to obtain the product acquired through the subcontracting process. Specifically, in the case of subcontracts, the government has no immediate, direct contractual relationship with the firms performing the work or delivering the product under subcontract. In the absence of this immediate, direct contractual relationship, the government has no legal basis for administering or controlling the product delivery or work performance of the subcontractor. As such, the Government's only resource for administering and/or controlling product delivery or work performance is through the prime contractor.

The Federal government does have available to it, however, procedures for determining subcontractor responsibility, and these procedures are often utilized. Specifically, the FAR states that "generally, prospective prime contractors are responsible for determining the responsibility of their prospective subcontractors...Determinations of prospective subcontractor responsibility may affect the Government's determination of the prospective prime contractor's responsibility. A prospective contractor may be required to provide written evidence of
a proposed subcontractor's responsibility (FAR 9.104-4(a)). Also, the FAR states that "when it is in the Government's interest to do so, the contracting officer may directly determine a prospective subcontractor's responsibility (e.g., when the prospective contract involves medical supplies, urgent requirements, or substantial subcontracting) [underline supplied]. In this case, the same standards used to determine a prime contractor's responsibility shall be used by the Government to determine subcontractor responsibility (FAR 9.104-4(b).

The Preaward Survey. Specifically, procedures for determining contractor and subcontractor responsibility are available through preaward surveys, and in the case of small businesses, through the Certificate of Competency program.

Preaward surveys, are conducted "when the information on hand or readily available to the contracting officer is not sufficient to make a determination regarding responsibility." Generally, preaward surveys are not conducted for contracts of less than $25,000, or in the case of fixed price contracts, for contracts with a fixed price of less than $100,000. Certain exceptions do exist, however, in cases where circumstances may justify the cost of the survey or in matters that require referral to the U.S. Small Business Administration.

When a preaward survey is conducted by the Defense Contract Administration Service, the professionals responsible for the
survey complete a number of very comprehensive forms that contain information on the contractor's technical and production capabilities; financial capability and accounting system; and quality assurance plans. Specifically, preaward survey monitors, if requested by the contracting officer, may complete the following forms:

--SF1403, Preaward Survey of Prospective Contractor--General
--SF1404, Preaward Survey of Prospective Contractor--Technical
--SF1405, Preaward Survey of Prospective Contractor--Production
--SF1406, Preaward Survey of Prospective Contractor--Quality Assurance
--SF1407, Preaward Survey of Prospective Contractor--Financial Capability, and
--SF1408, Preaward Survey of Prospective Contractor--Accounting System.

It is through this preaward survey that any weaknesses in the proposed contractor's ability to perform, produce, and deliver the specified product at the level of quality and within the time required by the proposed solicitation would likely be discovered. For it is through this survey that a contractor's proposed subcontracting plan will be examined (SF1405--Production). Further, it is through this survey that the contractor's technical capabilities with respect to the requirements of the proposed contract will be evaluated.

Further, when a preaward survey of the prime contractor is coupled with a preaward survey of the subcontractor, as was found to be the case in many of the Walsh-Healey case files examined,
further assurance is provided of the ability of the proposed team to provide the product to the Government within desired time and quality specifications.

The Certificate of Competency Program. In the case of small businesses, when a preaward survey report is negative, thus suggesting that the prospective contractor is deficient in some or all of the factors being evaluated, the contracting officer upon making the determination of nonresponsibility must "refer the matter to the Small Business Administration, which will decide whether or not to issue a Certificate of Competency (CoC)" (FAR 9.104-3(e)). The CoC is "a written instrument issued by SBA to a Government contracting officer, certifying that a small concern (or group of such concerns) possesses the responsibility or eligibility (with respect to the Walsh-Healey Public Contracts Act) to perform all or part of a specific Government procurement (or sale) contract."34 In short, through the issuance of a CoC, SBA can reverse the determination of nonresponsibility. Specifically, the contracting officer must recognize the firm's responsibility upon SBA issuance of a CoC.

In the process of determining whether to issue a CoC to the prospective contractor, SBA undertakes its own independent

investigation of the problem at issue. Specifically, at the contracting officer's request, SBA will undertaken an investigation of those factors in which the firm was judged to be nonresponsible, i.e., the firm's capacity, credit, tenacity and perseverance, and/or integrity. In this investigation, SBA requests certain information from the firm and conducts its own site visit to the firm's place of business. At the conclusion of the investigation, an analytical report is prepared outlining the reasons for denying or granting a CoC and a formal meeting of the regional CoC committee is held in order to review this report and make a final recommendation for action.

It is during the investigation of a firm's capacity to perform the proposed contract, that SBA is presented with an opportunity to judge the prospective contractor's ability to deliver a quality product within the required time frame desired. Specifically, an investigation of capacity "means the overall ability of a prospective small business contractor to meet the quality, quantity, and time requirements of a proposed contract, plus other commitments. Certification of capacity means that SBA finds that the prospective contractor has the necessary organization, experience, operational controls, materials, skills, equipment and facilities, or has the ability to obtain them on a timely basis, and is able and can be expected to comply with the required or proposed delivery or performance schedule."\(^{35}\)

\(^{35}\) Ibid. p. 28.
It is during this investigation of capacity that SBA conducts its own independent investigation of the prime contractor's relationship with the proposed subcontractor. Additionally, it is through this investigation that the industrial specialist determines the applicability of the firm's current inventory to the contract item.

It is during the capacity investigation, that SBA is presented with an opportunity to judge the extent to which the proposed contractor is, indeed, a "bid broker" with questionable ability to control product quality and delivery through any proposed subcontractual relationships.

During the capacity investigation, the CoC industrial specialist is advised that "in cases where a substantial or critical portion of the work is to be subcontracted, or where the contract is to be performed as a joint venture, it may be desirable or necessary to inspect the plant and facilities of the proposed subcontractor or joint contractor. ... The reports of such inspections or plant surveys [are] included in the files sent to the final action office. Subcontract agreements should be in writing and a copy included with the plant survey." 36

The current procedures used to determine contractor "responsibility," are considered to possess the basic ingredients required to

36 Ibid., p. 30.
deter "bid brokers" from participation in Federal contracting. Bolstering the contractor determination of responsibility process to ensure more effective prime contractor control over subcontractor performance is suggested as a method of more effectively deterring bid brokers, should this be a desirable Federal policy.
OVERVIEW

This chapter reviews the options available to policymakers desirous of improving the existing regulatory environment for small contractors as it pertains to the Walsh-Healey Public Contracts Act. Specifically, three options are reviewed: a) maintaining the status quo; b) revising the regulations; and c) changing the legislation either through amendment or repeal. The chapter provides a discussion of the benefits and costs of each policy option both for small suppliers as well as for the Federal government. Finally, for each option, recommendations for improving the current situation are offered.

OPTION 1: MAINTAINING THE STATUS QUO

The first option available to policymakers is to maintain the status quo. This option suggests that the Act and its existing implementing regulations should remain unchanged.

Benefits. Based on the results of this research, the benefit resulting from this proposed option is that bid brokers, i.e., certain small manufacturers with questionable ability to produce an item and certain small suppliers with questionable ties to product manufacturers and with questionable business viability, will continue to be singled out for special scrutiny in an attempt to prevent them from selling their supplies to...
the government. It should be emphasized, however, that there often appears to be inconsistency in the extent to which Walsh-Healey regulations are imposed upon these firms, so there is some question as to the ultimate effectiveness of the regulations in accomplishing this purpose.

Costs. Definite costs will result from a Federal acquisition policy that continues to single out bid brokers for special investigation in the contract award determination process. First, numerous small suppliers using quite legitimate business methods and offering needed products at reasonable prices will continue to be entangled in the existing regulations. As emphasized earlier, the regulations as currently designed and implemented, work against certain types of small suppliers. Additionally, the Federal government will continue to pay higher prices for supplies provided by other than the lowest bidders.

Recommendations. Should this be the desired policy option, the results of this research suggest that an educational campaign targeted toward contracting officers may be in order. This campaign should focus on further specifying and delineating the Walsh-Healey eligibility criteria so that inconsistent applications of the regulations may be reduced.

OPTION 2: REVISING THE REGULATIONS
In the case of Walsh-Healey, regulatory revision would be an attempt to maintain the current parts of the implementing
regulations that "do no harm" and eliminate the parts which interfere with the competitive process.

**Benefits.** By revising the Walsh-Healey implementing regulations, specifically those parts of the regulations having to do with contractor eligibility, an attempt would be made to reduce the chances that today's "legitimate" small suppliers offering quality products would be denied contracts.

**Costs.** The costs or perceived disadvantages of simply changing the regulations of an Act which appears no longer to serve its original purpose, is that the future is not always clear. Proposed regulatory changes that appear quite workable today may not be so effective a number of years in the future, particularly in an environment marked by rapidly changing technological advances. The regulatory history of Walsh-Healey to date emphasizes the attempts to revise the regulations in the face of advancing technology or to make exemptions in order to accommodate special classes of firms. Additionally, in the process of attempting to determine the exact nature of such revisions, a number of small firm contract casualties are the result--casualties which can make the difference between business survival and failure.

**Recommendations.** In the face of these benefits and costs, however, should regulatory revision be a desired policy option, then the following recommendations are offered for needed
revisions along with an indication of the type of supplier that these changes will accommodate:

**SMALL SUPPLIERS TARGETING THE FEDERAL GOVERNMENT AS CLIENT OR OFFERING PRODUCTS PURCHASED EXCLUSIVELY BY THE FEDERAL GOVERNMENT**


A bidder may qualify as a regular dealer under 41 CFR 50-201.101(b) if it owns, operates, or maintains a store, warehouse, or other establishment in which the commodities or goods of the general character described by the specifications and required under the contract are bought, kept in stock, and sold to the public in the usual course of business.

Proposed Change: Eliminate the underlined section above.


That sales are made regularly in the usual course of business to the public, i.e., to purchasers other than Federal, State, or local Government agencies; this requirement is not satisfied if the contractor merely seeks to sell to the public but has not yet made such sales; if Government agencies are the sole purchasers, the bidder will not qualify as a regular dealer, the number and amount of sales which must be made to the public will necessarily vary with the amount of total sales and the nature of the business.

Proposed Change: Eliminate the underlined section above. Encourage U.S. Department of Labor to re-evaluate this interpretation of a regular dealer which has remained administrative law since 1961.

**RECENTLY ESTABLISHED DISTRIBUTORSHIPS**

...A bidder who desires to qualify for award as a regular dealer must show to the satisfaction of the contracting agency, prior to any award that it is engaged in an established, regular business meeting all the criteria of 41CFR 50.201.101(a)(2). It is not enough in the case of a regular dealer to show only that arrangements have been made to set up such a business; before an award can be made, it is essential that it shows an already established business regularly dealing in the particular goods or goods of the general character offered to the Government.

Proposed Change: Eliminate underlined section above.


A bidder must be able to show before award: that the bidder has an establishment or leased or assigned space in which it regularly maintains a stock of goods in which it claims to be a dealer; if the space is in a public warehouse, it must be maintained on a continuing and not on a demand, basis; [or, a new business must show arrangements have been made to establish a place of business other than for the purpose of the proposed contract].

Proposed Change: Eliminate underlined section above; Add bracketed section above.


That the business is an established and going concern; it is not sufficient to show that arrangements have been made to set up such a business.

Proposed Change: Encourage U.S. Department of Labor to re-evaluate this interpretation which has remained administrative law since 1961. Eliminate underlined section above.

SUPPLIERS PROVIDING SPECIALTY PRODUCTS DESIGNED TO CUSTOMER SPECIFICATIONS AND MANUFACTURER REPRESENTATIVES

That the stock maintained is a true inventory from which sales are made; the requirement is not satisfied by a stock of sample or display goods or by a stock consisting of surplus goods remaining from prior orders, or by stock unrelated to the supplies which are the subject of the bid, or by a stock maintained primarily for the purpose of token compliance with the Act from which few, if any, sales are made (unless goods or products are custom made or because of the nature of the product or business arrangement with the manufacturer, it would be inappropriate to stock. A new business must show firm commitments in excess of contract amount for the same product or goods of the same general character.)

Proposed Change: Eliminate underlined portion; Add bracketed portion. Request that the U.S. Department of Labor seriously re-evaluate its interpretation of inventory requirements outlined in the underlined portion in order to accommodate new types of suppliers that do utilize display samples and that do offer custom or specialty products where the stocking of inventory is not applicable.


That sales are made regularly from stock on a recurring basis; they cannot be only occasional and constitute an exception to the usual operations of the business; the proportion of sales from stock that will satisfy the requirements will depend upon the character of the business; (Unless goods or products are custom made or because of the nature of the goods or product or because of the business arrangement with the manufacturer, it would be inappropriate to stock).

Proposed Change: Add bracketed section above.

DISTRIBUTORS UNDERGOING PRODUCT DIVERSIFICATION


That the goods stocked are of the same general character as the goods to be supplied under the contract; to be of the same general character, the items to be supplied must be either identical with those in stock or goods for which dealers in the same line of business would be an obvious source.
Proposed Change: Eliminate underlined section above.

DESIGNERS AND INSTALLERS OF HIGH TECHNOLOGY SYSTEMS

Regulations, Part 50-206: The Walsh-Healey Public Contracts Act Interpretations, 50-206.52(b)(1)

[Assembly can now mean to wire or install together into an operational, customized system various "off the shelf" components which may or may not have been manufactured by the assembler].

Proposed Change: Add the bracketed section above to the definition of Assembler.

OPTION 3. CHANGING THE LEGISLATION THROUGH AMENDMENT OR REPEAL

This policy option centers on changing the Act either through amendment or repeal. Amendment of the Act is proposed in order to eliminate the stipulation that supply contracts over $10,000 must be awarded to regular dealers or manufacturers. The case for amendment is based on the improvement in the Federal acquisition statutes governing and defining "responsible" contractors that has occurred since 1936 when Congress was searching for an appropriate way to ensure responsibility in Federal supply contracting. A review of the benefits and costs of this policy option is offered below.

Benefits. The benefits resulting from this policy option are three-fold. First, small firm competitiveness both today and in the future would be enhanced through the elimination of regulatory requirements that many consider to be outmoded in
today's business environment and that might require constant revision in order to keep up with changing technology in the future. Second, the Federal acquisition process would be streamlined by the elimination of regulatory requirements which may be considered to duplicate, for the most part, existing "responsible" contractor determination procedures. Third, the force of the policy statement emanating from the legislation would remain: that the Federal government is concerned that its contractors uphold decent labor standards.

Costs. The costs resulting from this policy option are difficult to quantify, but would ultimately be reflected in the loss to the Government that might accrue from dealing with truly questionable suppliers that might slip through the existing responsibility process without the additional scrutiny of subcontractual arrangements that the Walsh-Healey regulations may provide. This loss potentially would be reflected in defective products and/or product defaults or delivery delays of an unknown magnitude. Concomitantly, however, the reduction in costs that would accrue both to the Federal government and to small firms from a more streamlined regulatory process could well outweigh this concern.

Recommendation. Should this be the desired policy option, then it is recommended that the Walsh-Healey Public Contracts Act be amended to delete the stipulation that Federal supply con-
tracts in excess of $10,000 be awarded to "regular dealers" or "manufacturers."

The final policy option to be considered is that of repeal. The case for repeal of the Walsh-Healey Public Contracts Act stems from three factors, as follows:

a) that the Act currently serves a function in Federal contracting that is different than that envisioned by its Congressional authors;

b) that fair labor standards legislation is widely implemented today with the result being protection of labor that the Congressional authors particularly desired; and

c) that improvements in the Federal acquisition process currently offer the mechanism for ensuring that only responsible contractors deal with the Federal government; this mechanism, if strengthened, could provide the required protection against questionable subcontractual arrangements that are particularly applicable to the bid broker.

As this report has emphasized, the Walsh-Healey Act was enacted to ensure that Federal contracts were awarded only to firms that upheld decent labor standards and provided decent wages for their employees. In 1936, the lowest bidders on Federal contracts were often found to be bid brokers who were able to offer low contract prices because of considerable subcontracting to firms employing labor under "sweatshop" conditions—both offering low wages and a poor working environment. Today, the issue of "bid brokering" has become de-linked from the issue of treatment of labor. Today, Walsh-Healey simply serves, albeit inconsistently, to
deter "bid brokers" from receiving Federal contracts. In the process, it can be argued that Walsh-Healey interferes with the competitive process in Federal acquisition, and therefore, runs counter to certain existing Federal acquisition principles, including the promotion of competition in Federal contracting and the desire to purchase "property and services of requisite quality ...at the lowest reasonable price."\(^{37}\)

**Benefits.** The benefits resulting from repeal of the Walsh-Healey Public Contracts Act are as follows: outdated legislation which serves a purpose other than that originally envisioned would be eliminated, thus streamlining the Federal regulatory process and further promoting the goal of competition in Federal contracting. Additionally, another basic Federal acquisition principle would be furthered: the fostering of fair dealing and equitable relationships with the private sector.\(^{38}\)

**Costs.** Without the Walsh-Healey Public Contracts Act, a formal law acknowledging that the Federal government prefers to award its supply contracts to firms that uphold decent standards for labor would be eliminated. It could be argued that removal of such law, and the policy statement resulting from that law, might have important negative consequences given the power of the Federal contract mechanism. In this context, it could be

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\(^{37}\) Thybony, *op. cit.*, p. 10.

\(^{38}\) Thybony, *op. cit.*, p. 11.
argued while the actual need for Walsh-Healey may have been eliminated by more recent fair labor standards legislation, the requirement for the formal policy statement is still a critical ingredient of Federal labor policy in the United States.

It can be argued that the process of evaluating questionable suppliers, particularly those that are heavily dependent upon subcontracting for product delivery, would be made more difficult by repeal of Walsh-Healey. This stems from the fact that Walsh-Healey now provides implementing officials with a concise set of guidelines to utilize in the eligibility determination process. To simply eliminate the Act, as is, with no further strengthening of the existing prospective contractor eligibility determination process would be to enhance the possibility that irresponsible suppliers incapable of guaranteeing product quality slip through the Federal contracting gate. By awarding contracts to these questionable suppliers, the Federal government does, indeed, risk the possibility of some losses resulting from faulty products and/or contractor performance.

Against this background, it can be argued, however, that the Federal government already has in place a process for determining the responsibility of contractors. This process also makes provisions for determining the responsibility of prospective small contractors through the Certificate of Competency Program (CoC). Specifically, through the CoC program, investigations of
small firm capacity, credit, integrity and tenacity are conducted. This process would continue to act as a deterrent to nonresponsible contractors with questionable ability to perform and/or deliver desirable products. While some questionable contractors might continue to slip through both the initial responsibility determination process and the CoC responsibility determination process, it might be argued that this is the price that will be paid for further streamlining of the competitive process in Federal acquisition. Certainly without Walsh-Healey, it would be vital to re-emphasize the critical importance of the responsibility determination process in ensuring that only reputable contractors are the benefactors of Federal contracts.
BIBLIOGRAPHY

BOOKS


PUBLIC DOCUMENTS AND REPORTS


PUBLIC DOCUMENTS AND REPORTS (CONTINUED)


--Third-Party Protests. A limited number of third party protests on the basis of Walsh-Healey were encountered during the course of the research. Specifically, unsuccessful contract bidders raised formal protests arguing that the announced contract winner was ineligible for contract award due to failure to meet one or several of the Walsh-Healey eligibility criteria.

--Inappropriate Walsh-Healey Referrals. A limited number of inappropriate Walsh-Healey referrals also were encountered during the course of this research. In these instances, nonprofit organizations were judged ineligible for contract awards on the basis of Walsh-Healey and were referred to SBA for eligibility determinations.

--Failure to Follow Appropriate Procedures. A limited number of instances were observed where contracting officers made Walsh-Healey referrals to SBA without first notifying firms of the question surrounding their eligibility and permitting them an opportunity to respond. Also, a few cases were observed, where the contract was awarded to a higher bidder without
giving the small firm low bidder an opportunity to respond.

Perceived Use of the "Supply" Contract to Eliminate Small Firms From the Competition. In several cases, it was perceived that contracts which should have been designated as "construction" contracts were designated as "supply" contracts. By utilizing the supply contract designation, small firms could be deemed ineligible due to Walsh-Healey, and then eliminated from the competition.

WALSH-HEALEY CONTRACT DENIALS: THE SMALL FIRM PERSPECTIVE
A purposive sample of 25 small firms denied contracts on the basis of Walsh-Healey regulations was drawn to participate in a telephone interview. To select the sample, firms were first divided into two categories based on their decision to file for a CoC to reverse the contract denial decision, i.e., file and no file. Although statistical inferences can not be drawn from the information acquired through this purposive sampling approach, it can provide qualitative information about the small firm experience with Walsh-Healey.

Of the firms interviewed, 23 were "Regular Dealers" and 2 were "manufacturers". They all dealt with a Walsh-Healey ruling in either FY 1984 or FY 1985. The firms interviewed maintain a wide range of business enterprises including: prefabricated struct-
ures, x-ray supplies, petroleum product distribution, lab apparatus, and truck parts.

The compiled findings of the telephone interviews reveal an interesting profile of small firms (See Table 3.10). Approximately 50% of the firms have been in business for over five years. Thirty-six percent of these firms had recorded sales exceeding $500,000 for the fiscal year that a Walsh-Healey ruling was applied. Over 50% of the firms interviewed employ less than 5 persons. When questioned about the value of inventory, 36% stated that inventory was impossible to maintain in their service area.

Table 3.10 Profile of Sampled Firms

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Sales</th>
<th>Value of Inventory</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;5</td>
<td>&lt;$250,000/yr</td>
<td>&lt; $25,000</td>
</tr>
<tr>
<td>5-20</td>
<td>$250,000-$500,000</td>
<td>$25,000-$100,000</td>
</tr>
<tr>
<td>20-50</td>
<td>$500,000+/yr</td>
<td>$100,000+</td>
</tr>
<tr>
<td>50+</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Impossible to Maintain</td>
</tr>
</tbody>
</table>

64
All of the firm representatives interviewed responded negatively to the question "Do you think that the referenced contract denial was justified?" When asked "Has the contract denial affected your business in any way", 60% of the participants responded "yes".

Thirteen of the 25 firms chose to apply for a Certificate of Competency to reverse the contracting officer's decision. A substantial number used this procedure as a means of proving their legitimacy as either a regular dealer or manufacturer. Of the nine representatives of firms who did not apply for a COC, five stated that the process was not beneficial from either a financial or emotional standpoint; two stated that they were unaware of the process; the remaining two did not provide reasons for declining to file.

Of the 23 regular dealers interviewed, 20 were denied contracts on the grounds of non-compliance with regulation 50-206.53(b)(2) which states: "bidders may qualify as 'Regular Dealers' when they maintain stocks which are 'True Inventories' from which orders are filled. Stocks which are 'surplus' from previous orders, 'samples' or 'display' are not satisfactory". Four of these firms also were denied eligibility due to non-compliance with section 50-206.53(b)(5), which states "Bidders may qualify as 'Regular Dealers' when they make sales to both government agencies as well as to the public. If government agencies are
the sole purchasers, the bidders will not qualify as a regular dealer." The grounds for the remaining regular dealer denials are as follows: lack of financial capability, 1 firm; failure to stock inventory of the same general character, 2 firms. The two manufactures were denied contracts due to the lack of maintaining production facilities.

Sixty five percent of those firms denied contracts on the basis of failure to maintain a "true inventory" stated that the product which they deal with is impossible to stock for a number of reasons:

1) the product is made to order,
2) the product is too large to store, or
3) it is not cost effective for the firm to maintain an inventory.

The thirteen different types of businesses represented in this analysis are as follows:

- Canned Seafood
- Prefabricated Refrigerators
- Prefabricated Exterior Structures
- Lab Apparatus
- Helicopter Differentials
- Library Shelving
- Custom Design Conveyer Systems
- Liquid Dirt Deflectors
- X-Ray Supplies
- Forklift Trucks
- Petroleum Products
- Hydraulic Ram Pumps
- Stereoscope Lens

Four of the 13 denied firms were denied eligibility on the basis of failure to maintain a true inventory, coupled with a lack of sales to the general public. The products involved in these
cases include the following; lab apparatus, helicopter differentials, x-ray supplies, and forklift trucks.

Aside from the difficulties that the above mentioned firms encountered with the application of the Walsh-Healey Public Contracts Act, three firms interviewed encountered the dilemma of misapplication of the act. Two of the three firms were advertising concerns who were notified, after they had spent time to apply for eligibility and after one had employed legal assistance, that they were exempt from the rulings due to a 1985 administrative exemption to Walsh-Healey.

The third firm affected by misapplication was one that maintained a blanket purchase agreement with a government agency. Apparently the agency with which they were offering a bid applied the $10,000 stipulation to a "blanket" order of items instead of to a single item. This misapplication of the regulations resulted in the suspension of the firm in question until such a time that the case be resolved.

In reviewing the case files in the regional offices it became evident that a large number of firms had difficulty with the use of the terms "Regular Dealer" and "Manufacturer". Thus, it was considered important, as part of the interview, to ask the small firm representatives, the following question: "Prior to the denial to this contract, what best describes your understanding of the term 'regular dealer' or 'manufacturer'.' The responses
of those interviewed compared with the definition offered by the regulations indicates that a discrepancy has occurred between the layman's understanding of the terms and the regulatory implications of the terms. The following is a sampling of the small firms definitions:

--"A regular dealer is one who sells on a regular basis."

--"A regular dealer is one who has an agreement with a factory to do business on a regular basis, and sells goods of the same general character."

--"A regular dealer is a person who does business on a regular basis, is in good standing with the manufacturer they represent, and conducts business in compliance with the rules, terms and regulations set forth by the manufacturer."

--"A manufacturer is someone who has a shop under their control, manufactures items and follows all phases of manufacturing", "A manufacturer designs, test, maintains quality control and ultimately manufactures an item to be sold."

Although the definitions are not as indepth as those set forth by the Department of Labor, many of them hit at least one of the specifications defined by the regulations. Interestingly enough, very few of the small firms included comments on maintaining an inventory. It is equally important to point out that many of the respondents stated that they did not understand the definitions outlined by the regulations. Others stressed that they felt that often times the definitions were misapplied, loosely applied, or applied with inconsistency. A comment by one small business owner sums up the problem: "the definition needs work, it is
too abstract and causes a lot of trouble when your interpretation is different, even if just slightly, from the governments."

Although, it should be stressed again that the opinions generated by the 25 telephone interviews by no means reflect the opinions of the 300 cases reviewed, they provide useful insights into the problems surrounding Walsh-Healey. Each of the firms interviewed indicated that they felt they had been treated unfairly. A few stressed the lack of cooperation and support from the Small Business Administration regional offices. Four of the firm representatives indicated concern that the Industrial Specialist assigned to investigate their particular cases were not qualified to review their business operations due to a lack of familiarity with the type of services in question.

A most revealing question asked in the interview, "Has the denial of this contract impacted your willingness to conduct business with the federal government" generated various responses. The percent of those answering "yes" and "no" to the question is split 50-50. Of those responding "yes" the tone included that of frustration and resentment. Those responding "no" either indicated that they needed to participate in business with the federal government to stay in business, or that "the denial is being used as incentive to make sure that next time everything is in order".

The issue of the of the Walsh-Healey Public Contracts Act in the current business world also surfaced in the course of the tele-
phone interviews. It should be noted that this issue was not included in the form of a question, but was brought up specifically by 32% of those interviewed. The general consensus of those who addressed the issue was that the Walsh-Healey Public Contracts Act "needs to be revised and updated, it puts undue stress on businesses and is out of place in today's business world". Additional comments are as follows: "The act is outdated, the limitation of $10,000 should be increased or Walsh-Healey will continue to fall behind today's market", "Walsh-Healey is a ridiculous act that should have been repealed in 1940", and "Walsh-Healey needs to come up to date with modern business practices."

THE COSTS TO SMALL FEDERAL SUPPLIERS

This section examines the costs of the Walsh-Healey implementing regulations to the individual firms faced with contract denials. Four types of costs are examined:

--initial dollar losses resulting from Walsh-Healey contract denials;

--dollar losses resulting from
  a) the failure to file for a CoC to reverse the contracting officer's denial decision; b) the failure to submit required materials during the CoC application period; and c) the failure to obtain a CoC from SBA;

--losses resulting from the lag time from denial to the resolution of the case, and

--losses resulting from duplicate referrals.
Initial Dollar Losses From Contract Denials. Overall, the failure to meet Walsh-Healey eligibility criteria cost small firms approximately $138.99 million through contract denials during Fiscal Years 1984 and 1985. Approximately $107.5 million was denied solely on the basis of failure to meet the Walsh-Healey eligibility criteria. The remaining $31.4 million was denied for dual reasons: both failure to meet Walsh-Healey eligibility criteria as well as failure to meet the contractor responsibility tests for capacity and/or credit (See Table 3.11).

Table 3.11 Federal Contract Dollar Losses to Small Suppliers for Failure to Meet Walsh-Healey Eligibility Criteria, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>Reason for Contract Denial</th>
<th>Number of Total Dollar Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Referrals</td>
</tr>
<tr>
<td>Walsh-Healey Only--</td>
<td>239</td>
</tr>
<tr>
<td>Failure to Meet</td>
<td></td>
</tr>
<tr>
<td>Walsh-Healey</td>
<td></td>
</tr>
<tr>
<td>Eligibility Criteria</td>
<td></td>
</tr>
<tr>
<td>Dual Reason--</td>
<td></td>
</tr>
<tr>
<td>Failure to Meet</td>
<td></td>
</tr>
<tr>
<td>Walsh-Healey</td>
<td></td>
</tr>
<tr>
<td>Eligibility Criteria as</td>
<td></td>
</tr>
<tr>
<td>well as Failure</td>
<td></td>
</tr>
<tr>
<td>to Meet Test of</td>
<td></td>
</tr>
<tr>
<td>Responsibility for:</td>
<td></td>
</tr>
<tr>
<td>--Capacity</td>
<td>45</td>
</tr>
<tr>
<td>--Credit</td>
<td>13</td>
</tr>
<tr>
<td>--Capacity &amp; Credit</td>
<td>52</td>
</tr>
<tr>
<td>TOTAL, DUAL</td>
<td>110</td>
</tr>
<tr>
<td>Unable to Determine</td>
<td>2</td>
</tr>
<tr>
<td>TOTAL, ALL</td>
<td>351</td>
</tr>
</tbody>
</table>
It should be emphasized that 44% of all of these dollar losses were tied up in one contract denial of approximately $48 million. The remainder of the dollar losses were spread over a total of 267 small firms. Given this situation, the median figure, $199,633, probably is an accurate representation of the small firm's loss through the contract denial process.

The financial impact of these losses on the firms involved depend to a large extent on the course they choose after the contract denial, however. For example, in all cases of contract denials, the small firm may apply for a Walsh-Healey eligibility determination to overturn the contracting officer's decision to deny the contract. These eligibility determinations may result in the issuance of a Certificate of Competency (CoC) by SBA certifying that the small firm does, indeed, meet the Walsh-Healey eligibility criteria and, therefore, should be awarded the contract. In cases where SBA issues a CoC, the contracting officer must award the contract to the small firm.

It should be emphasized that the small firm denied a contract also has the option of not applying for assistance to overturn the contract denial decision. If this occurs, the contract denial loss is automatic. The contract is awarded to the next lowest bidder.

For some firms the initial loss from the contract denial is temporary (See Table 3.12). A percentage of the lost dollars
can be recaptured for the firms either through direct awards or through the Walsh-Healey eligibility determination process conducted by the U.S. Small Business Administration. In the two fiscal years studied, 51 percent, or approximately $71.1 million eventually was returned to the lowest bidders. This amount somewhat skews the cost impact analysis, however, because of the direct award of the very large contract for approximately $48 million that was referenced earlier. When this one contract is eliminated from the analysis, it can be demonstrated that only approximately 25% of the Walsh-Healey related contract denial dollars are ultimately returned to small firms through either direct awards or SBA CoC issuances.

Table 3.12 Status of Recapture of Contract Dollars Denied to Small Firms Under Walsh-Healey Regulations, FYs 1984-1985

<table>
<thead>
<tr>
<th>STATUS OF DOLLAR LOSSES TO SMALL FIRMS UNDER WALSH-HEALEY REGULATIONS</th>
<th>LOSSES</th>
<th>RECAPTURED LOSSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Amount of Small Firm Contract Denials*</td>
<td>$138,989,824</td>
<td></td>
</tr>
<tr>
<td>Amount Recaptured</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--through CoC Issues</td>
<td>$21,110,617</td>
<td>$49,967,806**</td>
</tr>
<tr>
<td>--through Direct Awards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$71,078,423</td>
</tr>
<tr>
<td>Unable to Determine</td>
<td>$244,369</td>
<td></td>
</tr>
</tbody>
</table>

*Includes Both Single Walsh-Healey and Dual Walsh-Healey and Capacity/Credit Cases

**Includes the $48 million contract referenced earlier
At this juncture, it should be emphasized that SBA was able to recapture dollars for small firms for a variety of reasons. Specifically, of the $21.1 million recaptured for small firms through CoC issuances, SBA was able to regain dollars through the following methods:

<table>
<thead>
<tr>
<th>Reason</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>differing interpretation of inventory of the same general character</td>
<td>$ 2,465,528</td>
</tr>
<tr>
<td>differing interpretation of lack of &quot;true inventory&quot; and &quot;significant sales to the general public&quot;</td>
<td>$ 5,227,680</td>
</tr>
<tr>
<td>differing interpretation of no true inventory, especially applied in custom made order cases</td>
<td>$ 3,180,992</td>
</tr>
<tr>
<td>change in firm's certification status from manufacturer or regular dealer to manufacturer-assembler</td>
<td>$ 3,266,583</td>
</tr>
<tr>
<td>change in firm's certification status from regular dealer to manufacturer</td>
<td>$ 1,932,321</td>
</tr>
<tr>
<td>differing interpretation of necessary commitments required of newly entering manufacturers</td>
<td>$ 1,427,297</td>
</tr>
<tr>
<td>unable to determine reason for issuance (mainly cases identified in SBA Central Office, but not located in field)</td>
<td>$ 3,610,216</td>
</tr>
</tbody>
</table>

Total $21,110,617
Losses Resulting from Contract Denials. Dollars lost through contract denials account for the bulk of the Walsh-Healey regulatory impact on small firm suppliers. These losses can be categorized in three ways:

a) dollars lost because the COC appeal process was considered too time consuming or expensive by the firm owner, or because the owner failed to submit required materials to qualify for a CoC;

b) dollars lost because of the firm’s failure to obtain a CoC even though an application was made, and

c) the lag time from denial to the resolution of the case.

Once the initial contract denial decision is made, the firm has an opportunity to reverse that decision by obtaining a Certificate of Competency from the U.S. Small Business Administration. In the first instance, this research has demonstrated that "no file" decisions, i.e., the decision on the part of small firms not to seek assistance in overturning the contracting officer’s contract denial decision, cost small firms a total of $38.9 million in Fiscal Years 1984 and 1985 (See Table 3.13). Approximately $21.9 million of this amount were losses resulting from "no file" decisions on contract denials where a question of Walsh-Healey eligibility was the sole issue. The remaining amount, or approximately $17 million, resulted from "no file" decisions on contract denials where dual questions of firm capability were involved, i.e., questions of capacity, credit, and/or capacity and credit and Walsh-Healey.
Table 3.13 Value of Small Firm Contract Losses Resulting from Walsh-Healey Regulated Contract Denials Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>Total Loss, Contract Denials</th>
<th>$138,989,824</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Loss Resulting From Failure to File</td>
<td>$38,901,833</td>
</tr>
<tr>
<td>Total Loss Resulting From Problem With Application*</td>
<td>$8,373,836</td>
</tr>
<tr>
<td>Total Loss Resulting From Failure to Obtain an SBA CoC</td>
<td>$20,391,363</td>
</tr>
<tr>
<td>TOTAL VALUE OF CONTRACT LOSSES</td>
<td>$67,667,032</td>
</tr>
</tbody>
</table>

**Failure to Apply for An SBA CoC to Reverse Ineligibility Determination**

***Failure to Submit Required Materials to SBA in Appropriate Time Frame***

The reasons for the small firm decision not to apply for a Certificate of Competency to overturn the contract denial decision are numerous, but included:

- The firm owner was never apprised that this option was open to him.

- The process is expensive, with the staff time that must be taken away from the business while completing the paperwork and various legal fees.
- The realization that violations do exist as defined by the act and so an appeal would not gain them anything.

- The lack of desire to risk more time and money on the contract when the resources could be used in developing other markets.

Another type of loss for small firms denied contracts on the basis of Walsh-Healey regulations is the time involved in attempting to regain dollars lost through the initial contract denial. The time involved in a Walsh-Healey case can be extensive. Few small firms can afford to have their resources tied up in a lengthy contract decision rather than actively seeking new markets. The following table shows two time units involved in a Walsh-Healey case:

a) the length of the case from the bid due date to final resolution of the case; and

b) the delay period—the time occurring from the date of Determination and Findings to the final resolution of the case.

These periods are quantified by the national average, the lowest regional average and the highest regional average (See Table 3.14).

A firm can spend anywhere from one to sixteen months waiting to learn the outcome of the contract award. Two to five months of that time is opportunity time, that time beyond the average contract award cycle that the firm must wait to learn the outcome of the Walsh-Healey referral—time when their resources may be
stagnating because of not wanting to over commit to contracts or markets.

Table 3.14  Time Required for Resolution of Walsh-Healey Contract Denials, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>TIME (in months)</th>
<th>LENGTH</th>
<th>DELAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>NATIONAL AVERAGE</td>
<td>4.3</td>
<td>1.8</td>
</tr>
<tr>
<td>REGIONAL LOW</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>REGIONAL HIGH</td>
<td>16.0</td>
<td>4.9</td>
</tr>
</tbody>
</table>

A final cost to the firm that should be mentioned is the cost of duplicate referrals for Walsh-Healey. This occurs when the firm has been cited for alleged Walsh-Healey violation on more than one contract bid. Of the cases reviewed in FY84 and FY86, 109 or 30.7 percent, involved firms that had experienced duplicate Walsh-Healey referrals--thus extending the expense of Walsh-Healey to their business.

THE COSTS TO THE GOVERNMENT

The costs of the Walsh-Healey Act to the government are, in some ways, easier to quantify. The costs come in three basic forms:

--the additional cost of not contracting with the lowest bidder in the competitive process;
--the staff time required to process referrals; and,

--the delay time experienced in the receipt of the goods.

The first two have finite values, while the third item is once again an opportunity cost whose value depends on the urgency or the overall need for the supplies.

Table 3.15 works through the definable costs of the Walsh-Healey Public Contracts Act to the Federal government. Several assumptions have been made in order to complete these calculations.

a) When an actual next lowest bid was not available, 10% of the denial amount was used to represent the difference between the second lowest bid and the lowest bid. This figure was cited as a standard used by the regional offices.

b) The cost to the government is a total of the differences between the two lowest bids, when the lowest bidder did not recapture the amount through a CoC issue or a direct award. The savings figure is the difference between the two lowest bids when the firm was successful in recapturing the contract amount initially denied.

c) Two figures represented by an "a" or an "e" are given in each Cost and Savings category. This differentiates between the figures derived from the "actual" or "estimated" next lowest bids.

d) Staff time for processing contract denial referrals is estimated from figures provided in interviews at the regional offices. The following estimates were used for each case:

-Fours hours of clerical work at a GS-5 rating ($14,390); this equates to $6.92/hour x 4 hours = $27.68.
- Three hours of the Assistant Regional Administrators' time at a GS-16 ($61,296); this equates to $29.47/hour x 3 hours = $88.41.

- Three days of an Industrial Specialist's time at a GS-13.5 ($37,599-$44,430= an average of $41,014); this equates to $19.72/hour x 24 hours = $473.28.

These figures combine to a total unloaded staff expenditure of $589.37 per Walsh-Healey case. When a standard loading factor of 2.5 is added to this amount, a total staff expenditure of $1473.43 per Walsh-Healey case is derived.

e. In addition to the SBA staff time involved in processing referrals, a staff cost for the DCAS pre-award monitoring team is also involved. This is the team that investigates Walsh-Healey eligibility at the request of the contracting officer. Depending upon the size of the potential contract, one, two, or more DCAS officials may be involved in the pre-award survey. The costs outlined in this analysis are considered minimum: no travel costs are included; only one staff person's time plus minimum clerical support is calculated. DCAS official at a GS-13.5 ($37,599-$44,430= an average of $41,014). Amount of time required 2 day plant site visit; 2 days report preparation for a total of 4 days. This equates to a total unloaded staff expenditure of $631.04. Add 4 hours of clerical time at GS-5 rating ($14,390). This equates to $6.92/hour x 4 hours= $27.60. Total unloaded staff expenditure, DCAS official plus clerical support, = $658.47. When a loading factor of 2.5 is added to this amount, a total staff expenditure of $1,646.60 per Walsh-Healey case is derived.

As Table 3.15 demonstrates, Walsh-Healey related contract denials cost the Federal government approximately $6.35 million in FYs 1984 and 1985 because of failure to contract with the lowest bidder. Additionally, the contract denials cost the Federal government approximately $810,950 in staff costs to investigate and determine contractor eligibility.
Table 3.15 Cost of Walsh-Healey to the Federal Government, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>Additional Costs/</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RESULTING FROM</strong></td>
<td><strong>FROM</strong></td>
</tr>
<tr>
<td>Low Bidder</td>
<td>$ 386,863(a)</td>
</tr>
<tr>
<td>Fails to File</td>
<td>$ 3,036,382(e)</td>
</tr>
<tr>
<td><strong>SubTotal</strong> $ 3,423,244</td>
<td></td>
</tr>
<tr>
<td>Low Bidder</td>
<td>$ 1,420,240(a)</td>
</tr>
<tr>
<td>Does Not Obtain a CoC</td>
<td>$ 1,505,727(e)</td>
</tr>
<tr>
<td><strong>SubTotal</strong> $ 2,925,967</td>
<td></td>
</tr>
<tr>
<td>Low Bidder Obtained a CoC</td>
<td>$ 2,036,799</td>
</tr>
<tr>
<td>Direct Award:</td>
<td></td>
</tr>
<tr>
<td>Low Bidder’s Ineligibility Determination Is Reversed</td>
<td>$ 6,746,135</td>
</tr>
<tr>
<td><strong>Staff Processing for Walsh-Healey Eligibility Determinations:</strong></td>
<td></td>
</tr>
<tr>
<td>87 CoC Denials x 1473.43/case</td>
<td>$ 128,188</td>
</tr>
<tr>
<td>72 CoC Issuances x $1473.43/case</td>
<td>$ 106,087</td>
</tr>
<tr>
<td><strong>SubTotal</strong></td>
<td>$ 234,275</td>
</tr>
<tr>
<td><strong>Pre-Award Survey for</strong></td>
<td></td>
</tr>
<tr>
<td>-Walsh-Healey Only, 239 referrals</td>
<td>SubTotal $ 393,537</td>
</tr>
<tr>
<td>-Dual Cases, 110 cases</td>
<td>SubTotal $ 181,126</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$ 7,158,149</td>
</tr>
<tr>
<td><strong>$ 8,782,934</strong></td>
<td></td>
</tr>
</tbody>
</table>

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In contrast, the SBA CoC program coupled with direct awards resulting from a reversal of the contracting officer's initial decision, saved the Federal government approximately $8.78 million in Fiscal Years 1984 and 1985. This savings figure is somewhat skewed, however, because of the direct award of the very large $48 million contract, which resulted in a cost savings of approximately $6 million. When this savings is eliminated from the analysis, it can be determined that the activity stemming from the Walsh-Healey regulations resulted in a net loss (costs-savings) to the Federal government of approximately $4.4 million in Fiscal Years 1984 and 1985.

In conclusion, two other costs should be mentioned which are not accounted for in these totals. The first is the cost of delay in the receipt of the supplies mentioned earlier. The second cost, affects both the government and supply contractors alike. This cost stems from the problem of inconsistent application of the implementing regulations by federal contracting officers. Inconsistent application of the regulations results in the referral of firms that have successfully contracted with the government in the past.

On average, the delay in the receipt of goods to the Federal government caused by the investigation and processing of Walsh-Healey cases was found to be approximately 2 months. In contrast, a regional high of approximately 5 months and a regional low of approximately 1 month was identified.
The costs of contracting officer inconsistency are two fold. First, to the firm involved, the cost is the closing, at least temporarily, of a market once thought secure. To the government it is the expense of processing the case which on one hand, should never have been referred, or on the other hand, should have been referred previously.

Of the 294 cases reviewed in the regional office case files, where it was possible to determine whether inconsistencies in Walsh-Healey application occurred, it was revealed that 102, or over one-third of these referrals, evidenced inconsistencies, i.e., firms claimed that they had had earlier contracts where Walsh-Healey was not an issue (See Table 3.16). Approximately 19% of all of the contract dollars were denied to firms that claimed having had previous Walsh-Healey regulated contracts where their "regular dealer" or "manufacturer" eligibility had not been questioned.
Table 3.16  Referrals Suggesting Inconsistent Application of Walsh-Healey Regulations, Fiscal Years 1984-1985

<table>
<thead>
<tr>
<th>Status of Walsh-Healey Referrals</th>
<th>Number of Referrals</th>
<th>Dollar Value of Inconsistent Referrals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inconsistent Referrals*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--Walsh-Healey Only</td>
<td>76</td>
<td>$ 22,342,041</td>
</tr>
<tr>
<td>--Dual, Including Walsh-Healey</td>
<td>26</td>
<td>$ 2,235,556</td>
</tr>
<tr>
<td>Subtotal</td>
<td>102</td>
<td>$ 24,577,597</td>
</tr>
<tr>
<td>Referrals Where No Inconsistency Was Evident</td>
<td>192</td>
<td>$ 107,093,882</td>
</tr>
<tr>
<td>Subtotal</td>
<td>192</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>294</td>
<td></td>
</tr>
<tr>
<td>Unable to Determine</td>
<td>57</td>
<td>$ 7,318,350</td>
</tr>
</tbody>
</table>

*Referrals Where Firm Documented Previous Contracts Where Same or Similar Product Had Been Supplied Without Walsh-Healey Eligibility Being Questioned
CHAPTER IV. THE WALSH-HEALEY PUBLIC CONTRACTS ACT:
IS CHANGE REQUIRED IN THE REGULATIONS OR THE LAW?

OVERVIEW
This chapter explores the need for change in the Walsh-Healey
implementing regulations as well as in the Act itself. Specifi-
cally, the chapter a) examines the regulations governing con-
tractor eligibility in an historical context; b) reviews develop-
ments subsequent to the time period in which these regulations
became administrative law—developments that suggest that the
criteria for contractor eligibility should seriously be re-exam-
ined for their appropriateness in today's Federal acquisition
and business environments, and c) discusses the continued need
for the Walsh-Healey Public Contracts Act, or at least portions
of the Act, in light of the passage of more recent fair labor
standards legislation and improvements in the Federal acquisition
process.

AN HISTORICAL ANALYSIS OF THE CONTRACTOR ELIGIBILITY REGULATIONS
An historical analysis of the regulations governing contractor
eligibility revealed that, for the most part, all of the rules
and interpretations surrounding contractor eligibility—a major
focus of concern for small Federal suppliers—officially became
administrative law prior to 1962. Certain noted exceptions
center on the rules and interpretations regarding the "assembler-
manufacturer" which developed during the late 1960's and early
1970's.
Of particular interest in this historical analysis was the time period in which the terms, "regular dealer" and manufacturer" as currently defined and interpreted in the regulations became administrative law. This analysis revealed three basic developments in the definition of these terms as follows:

Development 1. The first development centered on the definition of the terms in the initial U.S. Department of Labor regulations published in 1936; both of these definitions still appear in the regulations that are in effect today. Specifically, a regular dealer was and is defined as "a person who owns, operates, or maintains a factory or establishment that produces on the premises the materials, supplies, articles, or equipment required under the contract and of the same general character described by the specifications." A manufacturer was and is described as "a person who owns, operates, or maintains a factory or establishment that produces on the premises the materials, supplies, articles, or equipment required under the contract and of the same general character described by the specifications." It should also be noted that all of the alternative definitions of regular dealer, except for that defining a regular dealer in used automatic data processing equipment, became administrative law prior to 1960.

Development 2. The second development centered on a further elaboration of the definition of manufacturer and regular dealer. Specifically, in an official statement of policy, the Acting Administrator of the U.S. Department of Labor, Wage and Hour and Public Contracts Division, in a Circular Letter dated January 24, 1958, further specified the criteria by which contracting agencies may determine eligibility to receive awards of contracts subject to the Walsh-Healey Public Contracts Act. In this letter, the Acting Administrator stated that "the proper interpretations of these criteria for qualification to receive contracts is as follows:...a bidder who desires to qualify for award as a manufacturer must show before award that he is (1) an established manufacturer of the particular goods or goods of the general character sought by the Government or (2) if he is newly entering into such manufacturing activity that he has made all necessary prior arrangements for (a) manufacturing space, (b) equipment, and (c) personnel to perform
the manufacturing operations required for contract performance. These conditions must be met to the satisfaction of the contracting agency prior to any award of a contract covered by the Act. A bidder who desires to qualify for an award as a regular dealer must show to the satisfaction of the contracting agency prior to any award that he is engaged in an established, regular business meeting all the criteria of Section 201.101(b). It is not enough in the case of a regular dealer to show only that arrangements have been made to set up such a business; before an award can be made, it is essential that he show an already established going business regularly dealing in the particular goods or goods of the general character offered to the Government.

Development 3. The third development centered on even further interpretation and delineation of the terms, regular dealer and manufacturer. This development resulted in the criteria for manufacturer and regular dealer eligibility that currently appear in the regulations, Part 50-206: The Walsh-Healey Public Contracts Act Interpretations. Specifically, on July 6, 1961 in a Circular Letter officially superseding the Circular Letter dated January 24, 1958, the Administrator of the U.S. Department of Labor, Wage and Hour and Public Contracts Divisions outlined that "...a bidder who desires to qualify for an award as manufacturer must show before the award that he is (1) an established manufacturer of the particular goods or goods of the general character sought by the Government or (2) if he is newly entering into such manufacturing activity that he has made all necessary prior arrangements for (a) manufacturing space, (b) equipment, and (c) personnel to perform the manufacturing operations required for the fulfillment of the contract. A new firm which, prior to the award of a contract, has made such definite commitments in order to enter as manufacturing business which will later qualify it should not be barred from receiving the award because it has not yet done any manufacturing. This interpretation is not intended, however, to qualify a firm whose arrangements to use space, equipment or personnel are contingent upon the award of a Government contract....The Department of Labor interprets [the] regulation [governing regular dealer] as meaning: (a) that a dealer must have an establishment or leased or assigned space in which he regularly maintains a stock of the goods in which he claims to be a dealer. If the space is in a public warehouse, it must be maintained on a continuing, and not on a demand basis; (b) that the stock maintained must be a true inventory from which sales are made. This requirement is not satisfied by a stock of sample or display goods, or by a stock consisting of surplus goods remaining from prior orders, or by a stock
unrelated to the supplies which are the subject of the bid, or by a stock maintained primarily for the purpose of token compliance with the Act from which few, if any, sales are made. (c) that the goods stocked must be of the same general character as the goods to be supplied under the contract. To be of the same general character the items to be supplied must be either identical with those in stock or be goods for which dealers in the same line of business would be an obvious source. (d) that sales must be made regularly from stock on a recurring basis. They cannot be only occasional and constitute an exception to the usual operations of the business. The proportion of sales from stock that will satisfy the requirement will depend upon the character of the business. (e) that sales must be made regularly in the usual course of business to the public, i.e., to purchasers other than Federal, State, or local Government agencies. This requirement is not satisfied if the contractor merely seeks to sell to the public but has not yet made such sales. If Government agencies are the sole purchasers, the bidder will not qualify as a regular dealer. The number and amount of sales which must be made to the public will necessarily vary with the amount of total sales and the nature of the business."

SUBSEQUENT DEVELOPMENTS AFFECTING THE REGULATIONS

This section of the report examines the current regulations that define contractor eligibility in the context of a) changes that have occurred in warehousing and distribution and in Federal contracting since 1961—the last time that the regulations defining contractor eligibility as a "regular dealer" were revised, and changes that have occurred as a result of advances in technology since 1973—the last time that the regulations defining contractor eligibility as a "manufacturer" were revised, i.e., U.S. Department of Labor interpretations regarding the manufacturer-assembler.