

Date of Hearing: April 21, 2009

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE  
ECONOMY

V. Manuel Perez, Chair

AB 926 (Ruskin) – As Introduced: February 26, 2009

SUBJECT: Procurement and Small Businesses

SUMMARY: Requires certain advertising of state contracting opportunities to include a specified statement relating to an existing prohibition against the use of "loss leaders."

Specifically, this bill:

- 1) Requires every solicitation that appears in the California State Contracts Register to contain the following statement, "It is unlawful for any person engaged in business within this state to sell or use any article or product as a "loss leader," as defined.
- 2) Requires requests for proposals relating to the furnishing of equipment, materials, or supplies to the following statement, "It is unlawful for any person engaged in business within this state to sell or use any article or product as a "loss leader," as defined.
- 3) Requires contracts for information technology acquisition to include the following statement, "It is unlawful for any person engaged in business within this state to sell or use any article or product as a "loss leader," as defined.
- 4) Makes other technical, nonsubstantive changes relating to the Small Business Procurement Act.

EXISTING LAW:

- 1) Establishes the State Contract Act for the purpose of providing guidance on state contracting for goods, services, and information technology.
- 2) Prohibits a person engaged in business in California to sell any product at less than the cost or give away any product for the purpose of injuring competitors or destroying competition.
- 3) Defines "loss leader" as selling a product at less than cost:
  - a) Where the purpose is to induce, promote or encourage the purchase of other merchandise;
  - b) Where the effect is a tendency or capacity to mislead or deceive purchasers or prospective purchasers; or
  - c) Where the effect is to divert trade from or otherwise injure competitors.
- 4) Requires, except in cases of emergency, a department that contracts for goods in excess of \$25,000, or a higher amount as established by the director, to advertise the availability of the contract in the California State Contracts Register. In addition, the department is required to post a copy of the solicitation in a public place.

- 5) Designates the Department of General Services (DGS) to administer the state Small Business Procurement and Contract Act (Small Business Act), including, but not limited to, a certification process for disabled veteran-owned business enterprises (DVBEs) and small businesses and a streamlined procurement process for state contracts under \$100,000, which are exempt from advertising, bidding, and protest provisions in the State Contract Act.
- 6) Defines a small business as independently owned, not dominant in its field of operation, domiciled in California, employing 100 or fewer employees, and earning \$10 million or less in average annual gross revenues for the three previous years. A DVBE is defined as a business entity that is at least 51% owned or controlled by one or more disabled veterans, as specified.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Purpose of the bill: According to the author, the purpose of AB 926 is to ensure that the existing loss leader protections for small businesses are fully enforced and that larger businesses cannot undercut market prices to drive competitors out of business.

More specifically, the author believes that existing law has not provided adequate protections and has based this bill on an investigation by his office and the findings from an internal audit undertaken by DGS regarding its 2008 bundled contract with Office Depot. By highlighting current problems in the administration of the State Contract Law, the author hopes to bring its attention to all parties, state administrators, and those bidding on state contracts.

- 2) California Small Business: California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$1.8 trillion economy. Businesses with less than 100 employees comprise more than 98.3% of all businesses, and are responsible for employing more than 57.9% of all workers in the state.

Small- and medium-sized businesses are crucial to the state's international competitiveness and an important means for dispersing the positive economic impacts of trade within the California economy. Of the over 52,000 companies that exported goods from California in 2006, 95% were small- and medium-sized enterprises (SME) with fewer than 500 employees. These SMEs generated nearly half (44%) of California's exports in 2006. Nationally, SMEs represented only 29% of total exports. Again, these numbers include the export of only goods and not services.

Small businesses function as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth. Common types of microenterprises include engineering, computer system design, housekeeping, construction, landscaping, and personnel services.

- 3) The Small Business Act: The Small Business Act, administered through DGS, was implemented, more than 30 years ago, to establish a small business preference within the state's procurement process that would increase the number of contracts between the state and small businesses. In 1989, a DVBE component was added to state's procurement practices.

Since 2001, there have been four Executive Orders (EOs) specifying a 25% goal for small business and a 3% DVBE participation in state procurement contracts, including EO D-37-01 (2001), EO S-02-06 (2006), EO D-43-01(2001), and EO S-11-06 (2006). Statutory advancements were also made to strengthen the Small Business Act including SB 115 (Florez), Chapter 451, Statutes of 2005, which required DGS to establish a DVBE incentive program for state contracts; and AB 761 (Coto), Chapter 611, Statutes of 2007, which specifically codified the 25% small business participation goal for contracts related to revenues expended from the 2006 infrastructure bonds.

Notwithstanding the longstanding existence of the Small Business Act, statutory (up grades), and EOs, the state's success in obtaining small business and DVBE participation goals in state procurement contracts has been inconsistent.

For only the second time since the small business participation target was established in 2001, DGS has reported that in 2006-07 the state achieved its small business target by awarding 28.31%, or \$2.65 billion, of the value of all contracts to small businesses. This represents a \$1.3 billion increase in contracts from 2005-06. The state did not achieve its 3% DVBE participation goal, however, as only 2.8% of contract dollars, \$186 million, was awarded in contracts including DVBE participation.

- 4) DGS internal audit on the Office Depot Contract: In August of 2008, DGS released an internal compliance audit of an office supply contract with Office Depot, Inc (Office Depot), Contract No. 1S-06-75-55. In this contract, DGS had consolidated the state's primary office supply purchases into a single contract with the expectation of the state receiving significant discounts. Key issues investigated included whether the contract complied with state pricing rules and the small business and DVBE contracting requirement that they serve a commercially useful function (CUF).

In its findings DGS stated that over all, Office Depot was accurately pricing products that had been approved as core and non-core items. However, the audit also identified a number of over-charges totally \$34,399, which is 13% of the total cost of the \$26.4 million in core and non-core sales through February 2008.

Further, the audit identified several areas that required, in the opinion of the auditor, immediate attention prior to allowing the contract to continue in operation. Specifically, the audit noted that Office Depot had sold approximately 16,000 items for a total of \$14.2 million to state agency customers without applying prescribed discounts. This occurred by displaying "off-contract" products in the state supply catalog, which lead to high numbers of contract officers selecting these products rather than the core and non-core products covered by the state contract. While initially, Office Depot stated that they were not aware of any contract limitation on offering "off-contract" products within their catalog and online ordering website, Office Depot began to work with DGS on addressing this problem during

the course of the audit. Based on the audit findings, the state was able to promptly negotiate an additional discount of \$2.5 million.

Relative to CUF issues, the audit concluded that the small business consortium that Office Depot was engaged with met the requirements of existing law. The audit specifically stated that Office Depot had operated in a good faith manner.

In addition to the issues addressed above, the audit identified some shortcomings in the state's administration of this contract. As a result, DGS states that it has made improvements to its contract oversight and administration functions to better manage multi-faceted programs like the Office Depot contract in the future. These changes included:

- a. Implementation of a custom catalog limited to authorized office products that were scheduled to become available in mid-September 2008;
- b. Increased focus on usage reporting and contract management; and
- c. Deployment of a contracts management software tool that performs price and discount validation.

As noted above, the Office Depot contract was intended to expire on August 30, 2008. Rather than go out with a new Request for Proposal (RFP) while the audit was being finalized, DGS decided to extend the Office Depot contract until a new RFP could be prepared that reflected the lessons learned in the audit and a new award for office supplies was awarded. The Office Depot contract was set to expire on March 30, 2009, however, a second extension is currently in place.

- 5) Scope of the audit: As noted above, the scope of the audit included an investigation into the pricing of office supplies and on the use of small businesses and DVBEs to implement the contract. The author contends that the audit should have additionally addressed the issue of whether Office Depot engaged in illegal activities by using certain low cost products as a loss leader to either win the contract or in the implementation of the contract.

Historically, many state agencies have used their office supply contracts to meet their annual 25% procurement target for small businesses and their 3% target for DVBEs. By bundling the state office supply contract, many small businesses believe an important business opportunity is being eliminated. Small businesses are potentially already at a disadvantage to larger office suppliers who have access to bulk discounts. Therefore, enhanced enforcement of this existing loss leader law is central to small businesses ongoing ability to obtain state contracting opportunities.

According to the author, when DGS asked whether they had audited for violations of the loss leader law, the auditors responded that they were not aware of the law. The author states that implementation AB 926 addresses this lack of knowledge of a 1950s law by placing a reference to it within the State Contracting Code.

- 6) Technical amendment: The author may wish to address a technical drafting error relating to Section 4 of the bill. Section 4 relates to service contracts. The notice requirement, however, relates to the furnishing of equipment.

7) Related legislation: Below is a list of related legislation:

- a) AB 31 (Price): Makes several key changes to state procurement procedures including increasing the maximum contract threshold amount for awards to a small business and DVBE, under a specific streamlined procurement process, from \$100,000 to \$250,000. Further, the bill required contractors that made contract commitments to include small business or DVBE participation to report the final percent of the contract actually paid to these entities. Status: Awaiting hearing in the Assembly Appropriations Committee.
- b) AB 309 (Price): Requires the establishment of a 25% small business participation goal for all state entities and directs the DGS to monitor each agency's progress in meeting this goal. Status: Scheduled to be heard in the Assembly Committee on Jobs, Economic Development, and the Economy on April 21, 2009.
- c) SB 356 (Wright): This bill requires an agency considering the adoption of a regulation to consult with those persons and businesses potentially affected and would delete the condition that the agency only involve those parties if the proposal is large or complex. Status: The bill is scheduled to be heard in the Senate Committee on Business, Professions and Economic Development on April 27, 2009.
- d) AB 761 (Coto): This bill requires each state agency awarding contracts that are financed with proceeds from the infrastructure bonds approved by voters in November 2006 to establish a 25% small business participation goal for state infrastructure construction contracts and to provide specified assistance to small businesses bidding on state infrastructure bond-related contracts. Status: Signed by the Governor, Chapter 611, Statutes of 2007.
- e) AB 2773 (Price): This bill would have increased the maximum contract threshold amount for awards to small business, including microbusiness and DVBEs under the streamlined procurement process, from \$100,000 to \$250,000, as specified. Further, the bill required contractors that made contract commitments to include small business or DVBE participation to report the final percent of the contract actually paid to these entities. Status: Held under submission in Senate Appropriations Committee in 2008.
- f) SB 115 (Florez): This bill made various changes to the DVBE Program, including requiring DGS to establish a state agency-wide mandatory DVBE participation incentive. The bill also requires the DGS Small Business Advocate to provide specified services to small businesses and certified DVBEs. Additionally, this bill requires DGS to adopt a streamlined reporting procedure for state agencies to use in reporting their DVBE participation to the Department of Veterans Affairs. Status: Signed by the Governor - Chapter 451, Statutes of 2005.
- g) SB 642 (Denham): This bill increases the maximum contract threshold amount for awards to small business, including microbusiness and DVBEs under the streamlined procurement process, from \$100,000 to \$250,000, as specified. Further, the bill required contractors that made contract commitments to include small business or DVBE participation to report the final percentage of the contract actually paid to these entities.

Status: Set for hearing in Senate Governmental Organization Committee on April 28, 2009.

- 8) Double Referral: Assembly Rules Committee referred this bill to two policy committees. Should this measure pass the Assembly Committee on Jobs, Economic Development, and the Economy, it will be referred to the Assembly Committee on Business and Professions.

REGISTERED SUPPORT / OPPOSITION:

Support

California Small Business Association (sponsor)  
California Black Chamber of Commerce (sponsor)

Opposition

None known

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