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**Barriers to small business preference programs under EU Law**  
A comparative evaluation of EU and U.S. law, size standards, and policy

2016 no 2

**UrT**

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REPRINT FROM PROCUREMENT LAW JOURNAL

# Barriers to small business preference programs under EU Law

## A comparative evaluation of EU and U.S. law, size standards, and policy

*William T. Kirkwood\**

### Introduction

The world is evolving towards a harmonized set of rules across a variety of topics.<sup>1</sup> One of the many areas where harmonization is occurring is in the field of government acquisition.<sup>2</sup> One of the many important areas of harmonization within government acquisition relates to how small businesses should be supported by governments in the area of government acquisition.

The United States has a long history of zealously supporting small business. United States' efforts to support small business originally consisted of relatively simple efforts to facilitate the stability and growth of small businesses for the benefit of the U.S. industrial base.<sup>3</sup> U.S. efforts have evolved, however, into what is now a complex collection of small business programs. These small business

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<sup>1</sup> See, e.g., United Nations Economic Commission for Europe's Globally Harmonized System of Classification and Labelling of Chemicals (GHS), [http://www.unece.org/trans/danger/publi/ghs/ghs\\_welcome\\_e.html](http://www.unece.org/trans/danger/publi/ghs/ghs_welcome_e.html) (last visited December 12, 2015); Chun, Dongwook, *Patent Law Harmonization in the Age of Globalization: The Necessity and Strategy for a Pragmatic Outcome* (January 24, 2012). *Journal of Patent Trademark Office Society*, Vol. 93, No. 2, p. 127, 2011. Available at SSRN: <http://ssrn.com/abstract=1991536>; Caroline Freund and Sarah Oliver, *Gains from Harmonizing U.S. and EU Auto Regulations under the Transatlantic Trade and Investment Partnership*, PB 15-10, Peterson Institute for International Economics, <http://www.iie.com/publications/pb/pb15-10.pdf>. In the wake of the terrorist attacks in Paris on 13 November 2015, increased focus on cooperation and harmonized legislation is expected. See, e.g., Louise Shelley, *The Globalization of Crime and Terrorism*, The Bureau of International Information Programs of the U.S. Department of State, eJournal USA: Global Issues (February 2006), 42-45, <http://iipdigital.usembassy.gov/media/pdf/ejs/ijge0206.pdf>.

<sup>2</sup> Christopher R. Yukins & Steven L. Schooner, *Incrementalism: Eroding the Impediments to a Global Public Procurement Market*, 38 *Geo. J. Int'l L.* 529, 530 (2007).

<sup>3</sup> The U.S. small business programs began as an effort to support the stability of, and growth in the industrial base. For a good overview, see the history of the U.S. Small Business Administration at <https://www.sba.gov/about-sba/what-we-do/history> (last visited December 12, 2015).

programs are both facilitative of small business creation, as well as preferential in terms of the award of business.<sup>4</sup>

The European Union has historically taken a similar facilitative approach to support small and medium enterprises (SME's). This has been based on, among others, the underlying premise behind the formation of the EU,<sup>5</sup> and the resulting fundamental freedoms.<sup>6</sup> Notwithstanding this historical construct, it appears that the European Union may be taking steps toward adopting preferential small business programs such as already exist in the United States. The EU, however, will need to overcome legal difficulties should it wish to create such programs.

Public procurement law in the European Union is broadly purposed with maintaining political unity within the European Union. Efforts to support small business within the EU are done so with the understanding that small businesses increase competition, jobs, and stability. EU public procurement law and many of the transpositions of EU law into national law support efforts that are facilitative of small business growth and of small business participation in the public procurement market.<sup>7</sup> That said they also provide barriers to the creation of small business programs in the EU that are preferential in nature.<sup>8</sup> This article will

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<sup>4</sup> Facilitative small business programs are those that help small businesses get established and grow. They include counselling services, loan guarantees, and similar support. Facilitative small business programs are differentiated from preferential small business programs that distort competition by creating a preference for small businesses, such as through set-aside programs, bid advantages, and the like. See Martin Burgi, *Small and Medium-Sized Enterprises and Procurement Law--European Legal Framework and German Experiences*, 4 Pub. Procurement L. Rev. 284, 289-94 (2007). See also William Kirkwood, *The evolution of small business preferences in the United States, and selected lessons learned for the European Union*, (2015) at 4 (available from the author at William@Kirkwoodonline.com)

<sup>5</sup> The underlying premise behind the formation of the European Union relates to cooperation and mutual benefit. See [http://europa.eu/about-eu/eu-history/index\\_en.htm](http://europa.eu/about-eu/eu-history/index_en.htm) for a concise history (last visited December 12, 2015); see also Troy A. Eid, *The European Union: A Brief Introduction*, 31 *Colo. Law. J.* 11 (MAY 2002); Tonya D. Horton, *An Introduction to the Euro*, 3 N.C. Banking Inst. 435, 437 (1999). Small businesses are inherently local entities and preference programs would create potential for accusations of unequal treatment and discrimination by member nations. Consequently, preferential programs are difficult in the EU context, whereas facilitative programs are not. See Burgi, *supra* note 5 at 286; see also Max V. Kidalov, *Small Business Contracting in the United States and Europe: A Comparative Assessment*, 40 *Pub. Cont. L.J.* 443,454 (2011).

<sup>6</sup> The four freedoms are taken from Part Three, Title II and Title IV of the Treaty on the Functioning of the European Union, and are, generally, 1) the free movement of goods, 2) the free movement of persons, 3) free movement of services (including the freedom of establishment); and 4) the free movement of capital [hereinafter Four Freedoms]. See Consolidated Version of the Treaty on the Functioning of the European Union, Oct. 26, 2012, 2012 O.J. (C326) 47, 53-65 [hereinafter TFEU]; see also Kidalov, *supra* note 6 at 454.

<sup>7</sup> See, e.g., Recital 2 of the preamble to Directive 2014/24/EU, of the European Parliament and of the Council of 26 February 2014 on Public Procurement and Repealing Directive 2004/18/EC, 2014 O.J. (L. 94) [hereinafter Directive 2014/24] at 65.

<sup>8</sup> See, e.g., Principles of non-discrimination such as in Recital 1 of the preamble to Directive 2014/24, *supra* note 8 at 65.

examine key features of the EU policy and public procurement directives and compare them to U.S. policy and resultant law, with an eye toward barriers to creating small business preference policies in Europe. In Part 1, definitions will be established that are important to this discussion. In Part 2, the justifications that establish the basis for small business preference programs in the EU and in the U.S. will be discussed. This will be followed by Part 3 & 4 which will, respectively, summarize the sources of EU and U.S. law related to the establishment and operation of small business programs. Part 5 will review the respective differences between EU and U.S. approaches to size standards.

## Part 1 - Definitions

It is important to establish certain definitions that are central to this discussion: the difference between primary and secondary policies in the European Union; the difference between facilitative SME programs and preferential SME programs; and finally, the definition of State aid in the EU.

Primary policies should be distinguished from secondary policies.<sup>9</sup> The Treaty on the Functioning of the European Union (TFEU)<sup>10</sup> establishes four foundational principles, the “four freedoms,”<sup>11</sup> for the creation of the EU single market. These principles reflect the primary policy of the European Union and directly influence the development of EU procurement law as it relates to that single market. Included in these principles or freedoms, is the free movement of goods and services.<sup>12</sup> Any secondary policies pursued through secondary legislation such as the pursuit of small business policies through EU regulations or directives, are subordinate to, and must not conflict with primary legislation and policies.<sup>13</sup> This has a direct implication on the formation of both facilitative and preferential small business programs.

Programs benefitting SMEs can be facilitative of SME development and participation in public procurement or they can be preferential in nature.<sup>14</sup> SME programs that are facilitative include those that establish loan guarantees<sup>15</sup> and training programs,<sup>16</sup> those that simplify the government procurement process<sup>17</sup>

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<sup>9</sup> Burgi, *supra* note 5 at 286.

<sup>10</sup> TFEU, *supra* note 7.

<sup>11</sup> Four Freedoms *supra* note 7.

<sup>12</sup> See Part Three, Title II and Title IV, respectively, of the TFEU, *supra* note 7 at 53 and 65.

<sup>13</sup> See generally, Part One, Title I of the TFEU, *supra* note 7 at 50.

<sup>14</sup> Burgi, *supra* note 5 at 287–294.

<sup>15</sup> See, e.g., Section 42 of the Small Business Act, 15 U.S.C. § 657n (2013), (addressing disaster assistance programs).

<sup>16</sup> See, e.g., The Federal Acquisition Regulations [hereinafter, FAR], 41 U.S.C. 106 – Federal Acquisition Regulations, Subpart 19.402(c)(6).

<sup>17</sup> See, e.g., Recital 84 of the preamble to Directive 2014/24, *supra* note 8, at 81.

or that break large procurements into smaller lots,<sup>18</sup> and the like. Programs that create preferences for SMEs are those that create special opportunities that favor SME's in the award of Government Contracts such as the set-aside programs,<sup>19</sup> or price evaluation preferences<sup>20</sup> created in the United States for government contract awards.<sup>21</sup> Preferential programs would also include those that take into consideration a characteristic of the small business, such as socio-economic attributes<sup>22</sup> and/or location.<sup>23</sup> The distinction between facilitation and preference is important, as programs that create SME preferences, particularly but not exclusively related to the award of government contracts, are substantially more likely to violate the fundamental freedoms, or primary policy of the European Union.<sup>24</sup>

Last, EU member states can also create SME programs that are characterized as State aid.<sup>25</sup> The European Commission defines State aid as “an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities”.<sup>26</sup> State aid may come in many variations, and is highly regulated.<sup>27</sup>

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<sup>18</sup> See, e.g., Recital 78 of the preamble to Directive 2014/24, *supra* note 8, at 79.

<sup>19</sup> See, e.g., FAR 19.5.

<sup>20</sup> See, e.g., FAR 19.1307 and FAR 52.219–4.

<sup>21</sup> Martin Burgi has referred to the distinction between facilitative or preferential as, respectively, SME Fair and SME Favouring. See Burgi, *supra* note 5 at 289–94.

<sup>22</sup> See, e.g., Section 8(a) of the Small Business Act, 15 U.S.C. § 637 (2013).

<sup>23</sup> See, e.g., FAR 19.13 (Historically Underutilized Business Zone (HUBZone) Program).

<sup>24</sup> The Europe 2020 growth strategy includes in its European Platform against Poverty an open ended provision for providing support programs that could include preferences. See Communication from the Commission, Europe 2020, A strategy for smart, sustainable and inclusive growth, COM(2010) 2020 final (Brussels, 3.3.2010) [hereinafter Europe Strategy]. This concept is included in Article 20 of Directive 2014/24, however, the scope of this provision is de minimis and consequently not considered a violation of the fundamental freedoms.

<sup>25</sup> A full discussion of State aid is outside of the scope of this paper, but is mentioned at a summary level for completeness.

<sup>26</sup> See [http://ec.europa.eu/competition/state\\_aid/overview/index\\_en.html](http://ec.europa.eu/competition/state_aid/overview/index_en.html) (last visited December 12, 2015).

<sup>27</sup> See Article 107 and 108 of the TFEU, *supra* Note 6; see also recital 2 of the preamble to Council Regulation (EU) 2015/1588 of 13 July 2015, on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to certain categories of horizontal State aid (codification), O.J. (L 248), 1 [hereinafter Regulation 2015/1588] (which establishes that compatibility of State aid with the internal market is a determination that rests with the Commission); recitals 5 & 6 of the preamble to Council Regulation (EU) 2015/1589 of 13 July 2015, laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification), O.J. (L248), 9 [hereinafter Regulation 2015/1589] (which establishes, respectively, Commission must authorize new State aid, and Member States must cooperate with the Commission); European Commission, *EU Competition law, Rules applicable to State Aid, Situation as at 15 April 2014*, Luxembourg, Office for Official Publications of the European Union, 2014, ISSN 1831-4961

ISBN 978-92-79-35609-4, doi 10.2763/61432, [http://ec.europa.eu/competition/state\\_aid/legislation/compilation/index\\_en.html](http://ec.europa.eu/competition/state_aid/legislation/compilation/index_en.html) ; European Commission, *State Aid, Manual of Procedures, Internal DG Competition, working documents on procedures for the application of Articles 107 and 108 TFEU*, Luxembourg, Publications Office of the European Union, 2013, Revision 10/7/2013, ISBN 978-92-79-30849-9, doi 10.2763/51842, [hereinafter State Aid Manual] [http://ec.europa.eu/competition/state\\_aid/studies\\_reports/sa\\_manproc\\_en.pdf](http://ec.europa.eu/competition/state_aid/studies_reports/sa_manproc_en.pdf) .

In general, State aid that does not risk distorting the competitive market, may be acceptable.<sup>28</sup> Conversely, State aid that distorts competition will be viewed as discriminatory and in violation of the fundamental freedoms based on the principle of free movement of goods and services.<sup>29</sup>

By their very nature, SMEs are inherently local entities. Consequently, secondary policies that create award preferences for SME's, are more likely to be viewed as inherently discriminatory and thus in violation of the fundamental freedoms. Similarly, all State aid programs benefitting SME's must be carefully crafted so as to not distort competition and violate the primary policy of free movement of goods and services.<sup>30</sup> With definitions now established, the justifications for promoting small business in the EU and U.S. should be reviewed.

## Part 2 – An Overview of the Justifications for Promoting Small Business in the EU and US

The European Union has traditionally justified SME programs based on the benefit that small and medium enterprises provide to the economy in comparison to large businesses. Such comparative benefits include improved job creation, heightened stability of employment during difficult economic times, and better or more evenly distributed wages.<sup>31</sup> Justification for supporting SME's from a government procurement perspective has also been based on the added competition and lower cost that they provide for government procurement, as well as with increased innovation. SME programs have also been supported by the obvious national security benefit they offer through increasing the industrial

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<sup>28</sup> *E.g.*, Regulation 2015/1588, *supra* note 28 at 2 (Recital 8 to the preamble of Regulation 2015/1588 states “many aid measures for innovation are relatively small and create no significant distortions of competition.”). *See also* Recital 7 to Regulation 2015/1588, *supra* note 28 at 1, which acknowledges “The Commission should be enabled to declare that, under certain conditions, aid to small and medium-sized enterprises... is compatible with the internal market and not subject to the notification requirement. *But see, e.g.*, Article 2 of Regulation 2015/1588, *supra* note 28 at 5 (the expectation remains, however, that any State aid provided, is de minimis and does not threaten to distort competition).

<sup>29</sup> *E.g.* Article 107(1) of the TFEU, *supra* note 7 at 91; *see also* Regulation 2015/1588, *supra* note 28 at 11 (the Commission has a right to obtain all necessary information to restore undistorted competition)

<sup>30</sup> Burgi, *supra* note 5 at 286.

<sup>31</sup> It is important to note that not all agree with the purported benefits of small businesses in comparison with large businesses. *See, e.g.*, Veronique de Rugy's working paper: *Are Small Businesses The Engine Of Growth?*, The American Enterprise Institute for Public Policy Research (December 21, 2005), <https://www.aei.org/press/are-small-businesses-the-engine-of-growth/> (last visited December 12, 2015).

base.<sup>32</sup> The grounding for, or context within which SME support programs have been offered in the EU, has been directly related to the formative ideals that supported the creation of the Union itself, namely unity, fairness, transparency, and non-discrimination. Of special importance are the fundamental freedoms established for the EU, including but not limited to the free movement of goods. Consequently, the traditional support for SME programs in the EU has been limited to programs that are facilitative of the establishment of SME's, rather than for programs that create preferences for SME's.

The rationale for small business programs in the United States differ from those in the EU. The original support for small business programs in the U.S. related to the desire to maintain and increase the industrial base, which was necessitated by the onset of World War II. Despite this difference in rationale, small business support programs in the U.S. had their start as facilitative programs for the creation, development, and growth of small businesses. As such, the origin of small business programs in the United States is roughly similar in purpose, to those of the European Union. The justification for small business facilitative programs in the United States evolved with the entry into the civil rights era. Today, small business programs in the United States are both facilitative and preferential, with a strong emphasis on the latter.

The European Union appears to be shifting its focus on SME programs to one that includes social and other preferences. Examples of this shift are seen in, among others, the inclusion of the United Nations Environment Program's (UNEP) Social Life Cycle Assessments (S-LCA) guidelines into the 2014/24 Public Procurement Directive,<sup>33</sup> the enactment of legislation in the United Kingdom and Wales such as the Public Services (Social Value) Act 2012,<sup>34</sup> in evaluations of the social clauses such as by Northern Ireland,<sup>35</sup> or in the Procurement

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<sup>32</sup> *E.g.*, European Commission Press Release, SMEs in the Strengthening of the European Defence Technological and Industrial Base, Ferdinando NELLI FEROCI, European Commissioner for Industry and Entrepreneurship, SMEs and EDTIB Seminar, La Spezia (10 October 2014).

<sup>33</sup> Directive 2014/24, Recital 96, *supra* note 8 at 83; *See also* Guidelines for Social Life Cycle Assessment of Products, United Nations Environmental Programme, ISBN: 978-92-807-3021-0, DTI/1164/PA, [hereinafter "S-LCA Guidelines"], [http://www.unep.org/pdf/DTIE\\_PDFS/DTIx1164xPA-guidelines\\_sLCA.pdf](http://www.unep.org/pdf/DTIE_PDFS/DTIx1164xPA-guidelines_sLCA.pdf). (The S-LCA Guidelines provide an approach to measuring socio-economic impacts which, as a result of its incorporation into Directive 2014/24 appear to be a consideration in determining the most economically advantageous tender.)

<sup>34</sup> *See* Public Services (Social Value) Act 2012, [hereinafter "Social Value Act"], <http://www.legislation.gov.uk/ukpga/2012/3/enacted>. (The Social Value Act requires consideration of social value in above-threshold procurements.) *See also* Lord Young, Social Value Act review – review, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/403748/Social\\_Value\\_Act\\_review\\_report\\_150212.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/403748/Social_Value_Act_review_report_150212.pdf).

<sup>35</sup> *See* <http://www.nicva.org/resource/social-clauses-northern-ireland>. (recommending use of social clauses in the award criteria).

Reform (Scotland) Act.<sup>36</sup> This shift in focus appears to be related to the desire to achieve “greater human well-being.”<sup>37</sup> From a comparative perspective, this reasoning is comparable to the civil-rights justification that drove the adoption of preferential policies in the U.S. in the 1960’s. Nevertheless, while this may seem to be a logical and laudable evolution that will increase the role that SME’s play in government procurement, the European Union and its member states will need to proceed carefully, as EU law creates many barriers to the creation of small business preferences.

### Part 3 – The European Legal Context

The framework for a discussion of barriers to small business programs and government procurement in the European Union includes, among others, the following primary sources:

- The TFEU<sup>38</sup>
- The EU Public Procurement Directive 2014/24<sup>39</sup>
- the Small Business Act for Europe,<sup>40</sup> and
- the European Code of Best Practices.<sup>41</sup>

Regulations such as 2014/651<sup>42</sup> and others which, together with Article 107 and 108 of the TFEU, address State aid provisions in the EU, will be briefly discussed but is a large and complex area that is beyond the scope of this article.

Articles 3 and 26 of the TFEU, among others, establish the broad principle

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<sup>36</sup> See <http://www.gov.scot/Topics/Government/Procurement/policy/ProcurementReform>. (establishing a duty for the contracting authority to include social considerations in procurements)

<sup>37</sup> See, e.g., S-LCA Guidelines, *supra* note 34.

<sup>38</sup> Parts One (Principles), Two (Non-discrimination and citizenship of the Union), and Three (Union policies and internal actions) are particularly important. See TFEU, *supra* note 7 at 50-59.

<sup>39</sup> See Directive 2014/24, *supra* note 8.

<sup>40</sup> See Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, and the Committee of the Regions, “Think Small First”, A “Small Business Act” for Europe, COM(2008) 394 final (Brussels, 25.6.2008) [hereinafter The Small Business Act for Europe], <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008DC0394&from=EN>.

<sup>41</sup> See Commission Staff Working Document European Code of Best Practices Facilitating Access By SMEs to Public Procurement Contracts, SEC (2008) 2193 (Brussels, 25.6.2008) [hereinafter European Code of Best Practices], [http://ec.europa.eu/internal\\_market/publicprocurement/docs/sme\\_code\\_of\\_best\\_practices\\_en.pdf](http://ec.europa.eu/internal_market/publicprocurement/docs/sme_code_of_best_practices_en.pdf).

<sup>42</sup> Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty [hereinafter “Regulation 651/2014”].



that the European Union shall ensure the functioning of the internal market<sup>43</sup> and that such internal market will not interfere with the free movement of goods, persons, services and capital.<sup>44</sup> Article 114 establishes the premise that while member states will transpose EU law into national law,<sup>45</sup> they will nonetheless preserve the principle and functioning of the internal market.<sup>46</sup> Further, the European Commission reserves the right to reject any such transposition that is discriminatory or is otherwise an “obstacle to the functioning of the internal market.”<sup>47</sup> Considering the TFEU alone, it would seem that any EU or national legislation formulated with the intent of creating small business preferences would be difficult to justify from the beginning. This is because, as mentioned earlier, SME’s are inherently local entities. As such, preferential SME legislation would seem to be at risk of creating a de facto constraint for foreign competitors and, therefore, inherently discriminatory and in violation of the fundamental freedoms.

As it relates directly to public procurement, the preamble to EU’s 2014 Public Procurement Directive establishes its conformance to the principles of the TFEU, including the TFEU’s four freedoms.<sup>48</sup> Specifically, Recital 1 states:

“The award of public contracts by or on behalf of Member States’ authorities has to comply with the principles of the Treaty on the Functioning of the European Union (TFEU), and in particular the free movement of goods, freedom of establishment and the freedom to provide services, as well as the principles deriving therefrom, such as equal treatment, non-discrimination, mutual recognition, proportionality and transparency. However, for public contracts above a certain value, provisions should be drawn up coordinating national procurement pro-

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<sup>43</sup> See, e.g., TFEU, *supra* note 7, at 59 (Article 3(1)(b) states “The Union shall have exclusive competence in...the establishing of the competition rules necessary for the functioning of the internal market”, Article 26(1) states “The Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market, in accordance with the relevant provisions of the Treaties”).

<sup>44</sup> TFEU, *supra* note 7, at 59, (Article 26(2) states “The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties”).

<sup>45</sup> TFEU, *supra* note 7, at 94 (Articles 114–118 address approximation of laws).

<sup>46</sup> TFEU, *supra* note 7, at 94 (Article 114 (1) states, in pertinent part, “...The European Parliament and the Council shall...adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.”)

<sup>47</sup> TFEU, *supra* note 7, at 95 (Article 114(6) states that “The Commission shall...approve or reject... national provisions...after having verified whether or not they are a means of arbitrary discrimination or a disguised restriction on trade between Member States and whether or not they shall constitute an obstacle to the functioning of the internal market.)

<sup>48</sup> See TFEU, *supra* note 7 at 53–65.

cedures so as to ensure that those principles are given practical effect and public procurement is opened up to competition.”<sup>49</sup>

The preamble to Directive 2014/24 addresses various aspects of public procurement that are relevant to the establishment of facilitative and preferential SME programs. Taken together, however, the preamble seems to support only those SME programs that are facilitative in nature, and restrict those that might establish preferences. This restriction of preferential programs is due to the potential for discrimination and distortion of competition. That said, there are areas of the new Directive that appear to leave options open for creating SME programs that are preferential in nature.

For example, Recital 37 of the preamble to Directive 2014/24 addresses the “appropriate integration of environmental, social and labour requirements into public procurement procedures.”<sup>50</sup> This paragraph addresses compliance with environmental, social, and labor laws within an economic operator, but confirms that compliance expectations should not result in direct or indirect discrimination against that economic operator. Nevertheless, it does seem that this recital could permit SME preferences that would be similar to those provided through limitation on subcontracting clauses found in the U.S, through inclusion of social and labor requirements.<sup>51</sup>

Recital 36, on the other hand, appears to create the prospect of SME preferences such as the various minority business set-asides found in the U.S. Such preferences would need to be established carefully so as to not violate the principles of non-discrimination and equal treatment.

Recital 90 establishes the principle that “[c]ontracts should be awarded on the basis of objective criteria that ensure compliance with the principles of transparency, non-discrimination and equal treatment, particularly in the area of Most Economically Advantageous Tender (MEAT) analysis.”<sup>52</sup> Recitals 92, 93 and Article 67, among others, allow for the inclusion of social and other aspects. Consequently, it seems that SME award preferences could be included in a MEAT analysis, provided that such inclusion does not distort competition<sup>53</sup>

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<sup>49</sup> Directive 2014/24, Recital 1, *supra* note 8, at 65.

<sup>50</sup> Directive 2014/24, *supra* note 8, at 71.

<sup>51</sup> See FAR 52.219-14 Limitations on Subcontracting.

<sup>52</sup> Directive 2014/24, *supra* note 8, at 82.

<sup>53</sup> It should be noted that Recital 46 to Directive 2004/18, the predecessor Public Contract Directive to Directive 2014/24, appears more open to the inclusion of social requirements in a MEAT analysis. This direct inclusion of social requirements did not transfer over to Directive 2014/24. See Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, 2004 O.J. (L. 134) at 121.

or violate the principles of equal treatment and non-discrimination.<sup>54</sup> This is a similar conclusion as is found relating to State aid.

State aid to SME's cannot be ignored when discussing SME support programs in the EU. State aid is addressed both in Articles 107 and 108 of the TFEU,<sup>55</sup> as well as by various regulations such as Commission Regulation 651/2014,<sup>56</sup> Council Regulation 2015/1588,<sup>57</sup> and Council Regulation 2015/1589.<sup>58</sup> The overall conclusion seems to be that State aid can be provided, but it may not distort competition.<sup>59</sup>

Within Directive 2014/24, State aid is addressed in areas such as Article 1<sup>60</sup> and Article 69<sup>61</sup>. While compliance with the primary policies of non-discrimination, transparency, and fairness is maintained in these provisions,<sup>62</sup> it does seem that the idea of inclusive growth and incorporation of ideals from the Europe 2020 strategy<sup>63</sup> may introduce the possibility that socio-economic considerations in public procurement are under consideration.<sup>64</sup> Notwithstanding this possible

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<sup>54</sup> See, e.g., Directive 2014/24, *supra* note 8, Recital 90 at 82.

<sup>55</sup> TFEU, *supra* note 7 at 91, 92.

<sup>56</sup> Regulation 651/2014, *supra* note 43.

<sup>57</sup> Regulation 2015/1588, *supra* note 28.

<sup>58</sup> Regulation 2015/1589, *supra* note 28.

<sup>59</sup> E.g., Article 107 (1) of the TFEU states "...any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market. See TFEU, *supra* note 7 at 91. See also State Aid Manual, *supra* note 28 at 3.

<sup>60</sup> See Directive 2014/24, *supra* note 8 at 96 (Article 1 acknowledges the freedom of Member States to define programs in conformance with Union law State aid rules).

<sup>61</sup> See Directive 2014/24, *supra* note 8 at 135 (Article 69 addresses processes to be used when State aid creates abnormally low tenders).

<sup>62</sup> Article 1 of Directive 2014/24 permits State aid, provided that it conforms with Union policy. Article 69 of Directive 2014/24 establishes the ability (but not the mandatory requirement) of a contracting authority to reject a bid that is abnormally low due to the effect of State Aid. See Directive 2014/24, Article 1, *supra* note 8, at 65 and Directive 2014/24, Article 69, *supra* note 8, at 135, respectively.

<sup>63</sup> Europe 2020 Strategy, *supra* note 25.

<sup>64</sup> Consideration of social aspects in public procurement is addressed in the preamble to Directive 2014/24 in, among others, Recitals 36 (reserved contracts), 37 (integration of social requirements into procurement procedures) 40 (addressing where observance of social and other requirements should take place), 45 (consideration of social and other criteria), 47 (social innovation), 75 (Social and other considerations and labeling), 92 (award criteria may include social aspect), 93 (VFM can include social considerations), 95 (utmost importance to fully exploit public procurement to achieve Europe 2020 strategy), 96 (addressing social lifecycle costing), 97 (social and environmental considerations), 98 (consideration of social considerations in the production process), and 99 (favouring of social integration of disadvantaged & vulnerable), 101 (exclusion of economic operators for violations of social obligations), 105 (social obligations of subcontractors), 114 (addressing thresholds and treatment of services with limited cross-border dimension), 118 (addressing reserved contracts for services in the field of health, social, and cultural services), 123 (fully exploit public procurement for Europe 2020 strategy), as well as in Article 18 (compliance with Union law related to environment, social, and labor law) and Article 20 (reserved contracts). See generally, Directive 2014/24, *supra* note 8.

consideration, the current expectation is that criteria related to the public procurement of works, supplies, or services must not discriminate against other member states.<sup>65</sup> This concern over equal treatment and non-discrimination is a consistent limitation for SME programs, and differs from that which is found in the U.S.

## Part 4 – The U.S. Legal Context

Perhaps one of the most significant distinctions between the European Union and the United States, as it relates to small business policy, may be that the U.S. does not have the same constraint associated with equal treatment of member states, as does the EU.<sup>66</sup> Rather, U.S. policy and law appear to be focused on providing maximum practicable opportunity for small businesses to participate in federal contracts<sup>67</sup> and view small businesses as entitled to a fair proportion of total government purchases.<sup>68, 69</sup> The reason for this lack of concern in the U.S. over equal treatment of member states, likely relates directly to the degree of economic integration within and among the United States, in comparison with that available in the European Union. As a consequence, the U.S. has had more freedom to create its government acquisition laws without the degree of concern over harming its union.

Small business policy and law related to government acquisition in the United States is found in the Small Business Act,<sup>70</sup> and in the Federal Acquisition Regulations.<sup>71</sup> The Small Business Act creates both facilitative small business programs, as well as preferential programs. These programs, and the Small Business Act itself, are administered and carried out by the Small Business Administration.<sup>72</sup> The Small Business Act also establishes, among other things, the small business goals

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<sup>65</sup> Directive 2014/24, *supra* note 8, at 84.

<sup>66</sup> While politicians regularly jockey for benefits for their home state, there does not appear to be any consideration of state of incorporation in U.S. federal procurement acquisition policy. Consequently, while the observation that small businesses are inherently local institutions is as true in the United States as it is in the European Union, the associated concern with regard to equal treatment of member states does not exist in the US. As a result, legislators in the U.S. have been free to create small business preference policies and law, without the degree of concern over equal treatment and discrimination that would worry European Union authorities. Perhaps ironically, it has been concern over discrimination against, and equal treatment of individuals, that has resulted in the creation of preference programs in the United States. Also important to remember, is that states generally are not obligated to follow U.S. federal government procurement law, whereas in the EU, member states must adhere to Union law, through the principle of approximation of laws.

<sup>67</sup> See Small Business Act § 8(d)(1).

<sup>68</sup> See Small Business Act § 2(a).

<sup>69</sup> For a good discussion of U.S. policy, See Max V. Kidalov, *Small Business Contracting in the United States and Europe: A Comparative Assessment*, 40 Pub. Cont. L.J. 443 (2011).

<sup>70</sup> The Small Business Act.

<sup>71</sup> FAR, *supra* note 17.

<sup>72</sup> See Small Business Act § 4(a).

that the U.S. Federal Government is expected to adhere to. It also enumerates the types of facilitative and preferential programs that are desired.<sup>73</sup> Annually, the Small Business Act requires that the President of the United States to establish small business participation goals for the U.S. Federal Government.<sup>74</sup> The Federal Acquisition Regulations codify the provisions of the Small Business Act that are applicable to Federal procurement,<sup>75</sup> as well as sets forth size standards.

## Part 5 – Size Standards

Size standards and what constitutes a small business is an important question that needs to be answered when discussing the policy for promoting small business through, among others, preference policies, as it has an obvious effect on the impact of small business legislation. As we will see, the EU and the U.S. have substantially different approaches for determining what constitutes a small business.

The European Union and its member states define small businesses as Small Medium Enterprises or SMEs. The definition of SME is established in Commission Recommendation 2003/361.<sup>76</sup> This Directive superseded the former definition established in 1996,<sup>77</sup> and the purpose of the update appears to be directed at updating thresholds; promotion of micro-enterprises;<sup>78</sup> improving access to capital, including R&D funds to spur innovation; and to prevent abuses of the SME definition by adding SME attributes relating to autonomy.<sup>79</sup> The new commission recommendation defines SME's in terms of "Staff Headcount" and "Financial Ceilings," but also adds three attributes related to autonomy, in order to prevent abuses of the SME definition. These three new attributes are defined in Article 3 of the Annex to the European Commission

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<sup>73</sup> See, e.g., Small Business Act § 15 (which discusses bundling), Small Business Act § 31 (which establishes the HUBZone program), and Small Business Act § 32 (which establishes Veterans programs).

<sup>74</sup> See Small Business Act § 15(g)(1)(A).

<sup>75</sup> See among others, FAR Part 19 (Small Business Programs), FAR Part 6 (Competition Requirements), and FAR Subpart 8.4 (Federal Supply Schedules).

<sup>76</sup> Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC), 2003 O.J. (L.124) [hereinafter "Recommendation 2003/361"].

<sup>77</sup> Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized enterprises (96/280/EC), 1996 O.J. (L. 107).

<sup>78</sup> Micro-enterprises are enterprises employing fewer than ten employees and with annual revenues of less than €10M.

<sup>79</sup> For a helpful guide to the new SME definition and discussion of differences with the 1996 definition, see the guide issued by the European Commission entitled "The new SME definition, User guide and model declaration."

Recommendation 2003/361/EC.<sup>80</sup> The definitions are nuanced, but can be summarized as follows:

1. Autonomous – where the SME is either completely independent, or has equity stake in another Enterprise (or vice versa) of less than 25%.
2. Partner Enterprise – where the SME has a greater than 25%, but less than or equal to 50% equity stake in another Enterprise (or vice versa).
3. Linked Enterprise – where the SME has a majority stake in another Enterprise (or vice versa).

The European Commission has established a number of helpful materials to aid government and industry in understanding and complying with the definitions of Micro, Small, and Medium-sized Enterprises.<sup>81</sup> Among them, is a SME User Guide which, according to the Guide “serves as general guidelines for entrepreneurs and other stakeholders when applying the SME definition.”<sup>82</sup> The matrix in Table 1, is one such helpful aid.

SME Definition: Thresholds for Staff Headcount & Revenue				
Enterprise category	Ceilings			
	Staff Headcount (number of persons expressed in annual work units)	Turnover	Or	Balance sheet total
Medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

*Table 1 – Matrix published by the European Commission displaying thresholds for “Staff Headcount” and “Financial Ceilings” for Micro, Small, and Medium-sized Enterprises<sup>83</sup>*

The legal basis for the definition of a SME exists solely in Commission Recommendation 2003/361 and this definitional basis has not changed since the Com-

<sup>80</sup> See Recommendation 2003/361, *supra* note 77.

<sup>81</sup> See [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index\\_en.htm](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm) for a listing of guides to the definition of SME.

<sup>82</sup> See European Commission, *User guide to the SME definition*, Luxembourg: Publications Office of the European Union, 2015, ISBN 978-92-79-45301-4 – doi:10.2873/620234, [http://www.etsi.org/images/files/membership/SME\\_definition\\_user\\_guide\\_2015.pdf](http://www.etsi.org/images/files/membership/SME_definition_user_guide_2015.pdf).

<sup>83</sup> Commission Staff Working Document on the implementation of Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises Brussels, 7.10.2009 SEC (2009) 1350 final.

mission Recommendation was published in 2003.<sup>84</sup> That said, the Commission Recommendation has been monitored and periodically reviewed.

The United States has a substantially more involved approach for qualifying businesses as small. In the US, the FAR<sup>85</sup> contemplate three basic types of small business: a Small Business Concern; a Small Business Subcontractor; and a Small Disadvantaged Business Concern. Each of these is defined in the FAR in section 2.101, together with variants of Small Business Concern of the types named or otherwise identified by The Small Business Act, such as HUBZone, Women Owned, and more.

A small business concern is defined in the Federal Acquisition Regulations (FAR)<sup>86</sup> as “a concern, including its affiliates, that is independently owned and operated, not dominant in the field of operation in which it is bidding on Government contracts, and qualified as a small business under the criteria and size standards in 13 CFR part 121 (see 19.102).”<sup>87</sup> This FAR definition goes on to explain that:

“[s]uch a concern is “not dominant in its field of operation” when it does not exercise a controlling or major influence on a national basis in a kind of business activity in which a number of business concerns are primarily engaged. In determining whether dominance exists, consideration must be given to all appropriate factors, including volume of business, number of employees, financial resources, competitive status or position, ownership or control of materials, processes, patents, license agreements, facilities, sales territory, and nature of business activity.”<sup>88</sup>

In addition to conformance with the FAR definitions of Small Business Concern, businesses in the United States Federal procurement system are further characterized as small for government contract award purposes based on three additional characteristics: small business size standards (in terms of revenue and/or employees), the industry that they are competing in, and the socio-economic characterization that they satisfy.<sup>89</sup>

The regime for qualifying small businesses based on size standards is establis-

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<sup>84</sup> See Recommendation 2003/361, *supra* note 77.

<sup>85</sup> See FAR 2.101.

<sup>86</sup> The Federal Acquisition Regulations in the United States are authorized by Title 41 of the United States Code. See FAR 1.103 Authority. The applicable FAR definition of “small business concern” finds its analogue in the Small Business Act (15 USC 14A) and, in particular, Chapter 14A, Section 632.

<sup>87</sup> See FAR 2.101.

<sup>88</sup> See FAR 2.101 & 15 USC 632.

<sup>89</sup> See FAR 19.102.

hed by the Small Business Administration<sup>90</sup> based on authority and guidelines codified in 13 CFR part 121, FAR subpart 19.1 and, in particular, FAR 19.102.<sup>91</sup> The SBA maintains a Table of Small Business Size Standards Matched to North American Industry Classification System Codes (NAICS).<sup>92</sup> This table establishes “numerical definitions or “size standards” for all for-profit industries”<sup>93</sup> that represent the “largest size that a business (including its subsidiaries and affiliates) may be to remain classified as a small business concern.”<sup>94</sup> The SBA’s Table of Small Business Size Standards, such as the excerpt listed in Table 2, lists for-profit industries by Sector and Subsector, and provides size standards in terms of revenue as well as in terms of employees.

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<sup>90</sup> The genesis and authority of the Small Business Administration is found in Title 15 of the United States Code, Chapter 14A.

<sup>91</sup> For readers unfamiliar with the difference between The United States Code (USC), The Code of Federal Regulations (CFR), and the Federal Acquisition Regulations (FAR), the following general contextual summary may be helpful: Laws that are successfully passed by the Congress of the United States become part of the USC and are published in the Federal Register. In so doing, they become part of United States Law. The various Agencies then create implementing legislation in the CFR, that implements the USC. The FAR is merely a portion of the CFR which was authorized by 41 USC Chapter 13. In particular, Chapter 1 of Title 48 of the CFR, contains the FAR. Chapter 2 of Title 48 of the CFR contains the DFARS.

<sup>92</sup> U. S. Small Business Administration’s Table of Small Business Size Standards Matched to North American Industry Classification System Codes [hereinafter SBA Table], [https://www.sba.gov/sites/default/files/files/Size\\_Standards\\_Table.pdf](https://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf) (last visited on December 12, 2015).

<sup>93</sup> See Small Business Administration, *What are the Small Business Size Standards?*, <https://www.sba.gov/content/what-are-small-business-size-standards> [hereinafter SBA Size Standards] (last visited on December 12, 2015).

<sup>94</sup> See SBA Size Standards, *supra* note 94; See also SBA Table, *supra* note 93.



NAICS Codes	NAICS Industry Description	Size Standard (US\$M)	Size Standard (EE's)
Sector 22 – Utilities			
Subsector 221 – Utilities			
221111	Hydroelectric Power Generation		500
221112	Fossil Fuel Electric Power Generation		750
221113	Nuclear Electric Power Generation		750
221114	Solar Electric Power Generation		250
221115	Wind Electric Power Generation		250
221116	Geothermal Electric Power Generation		250
221117	Biomass Electric Power Generation		250
221118	Other Electric Power Generation		250
221121	Electric Bulk Power Transmission and Control		500
221122	Electric Power Distribution		1,000
221210	Natural Gas Distribution		500
221310	Water Supply and Irrigation Systems	\$27.5	
221320	Sewage Treatment Facilities	\$20.5	
221330	Steam and Air-Conditioning Supply	\$15.0	
Sector 23 – Construction			
Subsector 236 – Construction of Buildings			
236115	New Single-family Housing Construction (Except For- Sale Builders):	\$36.5	

Table 2 – Sample of SBA Table of Small Business Size Standards based on 2012 NAICS

This table of size standards can be summarized as shown in Figure 3.

US Small Business Size Standards				
Enterprise category	Ceilings ( <i>depending on NAICS</i> )			
	Headcount	Or	Average Annual Receipts	Or Assets ( <i>financial institutions</i> )
Small	100 to 1500		\$.75M to \$38.5M	\$550M in Assets

Table 3 – Summary of US Size Standards

The SBA's methodology for establishing and adjusting small business standards is complex and ultimately is based on the discretion of the SBA Administrator<sup>95</sup> Size standards define eligibility for small business facilitative and preferential promotion efforts. As such, size standards directly define the criteria for entry into, and exit from small business promotion efforts. One of the most significant concerns with preferential small business policies and size standards relates to when a small business will graduate from support programs. If a small business graduates too early, it may find itself unprepared and unable to compete with large businesses.<sup>96</sup> This can have obvious additional impacts on attracting investment. Preferential small business programs obviously help small businesses to capture government business by lowering competition. They may, however, complicate a small business' exit from preference programs, as they do not help the small business to prepare itself to compete with large business. Consequently, small business preference programs may actually make sustainable long term growth for small business a more difficult challenge, compared with facilitative small business programs.<sup>97</sup>

## Conclusion

The reason for increasing support of SME's has many justifications, all of which can be classified as either facilitative or as preferential programs. The EU has traditionally established facilitative SME programs, and has avoided programs that are preferential and that violate fundamental freedoms such as the free movement of goods and services. Most writing related to small business programs in Europe conclude that programs that include preferences for small businesses will be improper in view of the EU's fundamental freedoms. The EU's Public Procurement Directive 2014/24 seems to support this conclusion based on its clear references throughout the directive to the principles of equal treatment and non-discrimination amongst member nations. Notwithstanding this, it seems equally clear that the EU and its member states have taken steps to increase its support of SME's, and is likely to continue that trend. Legislation such as the Public Services (Social Value) Act 2012 in the United Kingdom is

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<sup>95</sup> Congress has left the establishment and adjustment of small business size standards to the discretion of the SBA Administrator. The current (2009) methodology can be found here: <https://www.sba.gov/category/navigation-structure/contracting/contracting-officials/small-business-size-standards>. (last visited on December 12, 2015).

<sup>96</sup> The Small Business Administration acknowledged the difficulties associated with graduation from preference programs, such as the 8(a) program. *See, e.g.*, <https://www.sba.gov/blogs/how-prepare-your-business-graduate-8a-program>. (last visited on December 12, 2015).

<sup>97</sup> As mentioned earlier, facilitative programs which include training, education, and counselling, will help SME's gain the expertise they need in order to achieve long term growth. Facilitative programs such as process simplifications will yield benefits to all businesses.

evidence that there is a movement underway to consider more in the evaluation of best value or most economically advantageous tender, than has historically been addressed. The Europe 2020 Strategy and related documents such as the Guidelines for Social Life Cycle Assessment of Products support this conclusion. These movements appear to be heading in the direction of creating procurement preferences for SME's.

The EU will need to address the barriers contained in existing legislation that makes preferences presumptively illegal. Options worth exploring might include creating contract award preference criteria that reflect social criteria that aren't limited by member state geography. This will need to be done in order to maintain harmony throughout the EU and its member nations. The creation of preferences will help small businesses grow quickly by limiting competition, but must be tied to facilitative programs and carefully monitored so as to ensure that SME growth does not stall once small business programs are outgrown. Once this is done, however, it will lessen the difference between the policy framework for SME programs in the EU, and those in the US, and move the world one step closer to harmonized procurement systems.