

Overview of Select Provisions of SBA's Final Rule on Limitations on Subcontracting

On May 31, 2016, SBA published its final rule making changes to its regulations regarding limitations on subcontracting, affiliation, joint ventures, and more. This chart includes some of the key changes as compared to the prior rule. The rule became effective on June 30, 2016.

| <u>Rule Citation</u> | <u>Prior Rule</u> | <u>New Rule</u> |
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| <i>Limitations on Subcontracting</i> | | |
| 13 C.F.R. § 125.1(x) | Definitions that are important to SBA's Government Contracting Programs. | SBA defines <i>similarly situated entity</i> as a subcontractor that has the same small business program status as the prime contractor. In addition to sharing the same small business program status as the prime contractor, a similarly situated entity also must be small for the NAICS code that the prime contractor assigned to the subcontract the subcontractor will perform. |
| 13 C.F.R. § 125.6(a) | Prime contractors on 8(a), WOSB, EDWOSB, and small business set-aside contracts must perform: (1) for services contracts, 50% of the cost of the contract incurred for personnel with its own employees; (2) for supply or products contracts, 50% of the cost of manufacturing the supplies or products (not including the costs of materials); (3) for general construction contracts, 15% of the cost of the contract with its own employees (not including the costs of materials); and (4) for specialty trade construction contracts, 25% of the cost of the contract with its own employees (not including the cost of materials). | <p>In the case of a contract for services (except construction), the prime contractor will not pay more than 50% of the amount paid by the government to it to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 50% subcontract amount that cannot be exceeded.</p> <p>In the case of a contract for supplies or products (other than from a nonmanufacturer of such supplies), the prime contractor will not pay more than 50% of the amount paid by the government to it to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 50% subcontract amount that cannot be exceeded. Cost of materials are excluded and not considered to be subcontracted.</p> <p>In the case of a contract for supplies from a nonmanufacturer, the prime contractor will supply the product of a domestic small business manufacturer or processor, unless a waiver is granted.</p> <p>In the case of a contract for general construction, the prime contractor will not pay more than 85% of the amount paid by the government to it to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 85% subcontract amount that cannot be exceeded. Cost of materials are excluded and not considered to be subcontracted.</p> <p>In the case of a contract for special trade contractors, no more than 75% of the amount paid by the government to the prime may be paid to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 75% subcontract amount that cannot be exceeded. Cost of materials are excluded and not considered to be subcontracted.</p> |

| <u>Rule Citation</u> | <u>Prior Rule</u> | <u>New Rule</u> |
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| 13 C.F.R. § 125.6(b) | N/A | <i>Mixed contracts.</i> Where a contract combines services and supplies, the contracting officer shall select the appropriate NAICS code. The contracting officer's selection of the applicable NAICS code is determinative as to which limitation on subcontracting and performance requirement applies. In no case shall the requirements for both supplies and services contracts apply to the same contract. The relevant limitation on subcontracting for supplies or services contracts shall apply only to that portion of the contract award amount. |
| 13 C.F.R. § 125.6(c) | N/A | <i>Subcontracts to similarly situated entities.</i> A small business concern prime contractor that receives a contract and spends contract amounts on a subcontractor that is a similarly situated entity shall not consider those subcontracted amounts as subcontracted for purposes of determining whether the small business concern prime contractor has violated the limitations on subcontracting, to the extent the subcontractor performs the work with its own employees. Any work that the similarly situated subcontractor does not perform with its own employees shall be considered subcontracted. SBA will also exclude a subcontract to a similarly situated entity from consideration under the ostensible subcontractor rule. |
| 13 C.F.R. § 125.6(e) | N/A | <p><i>Determining compliance with applicable limitation on subcontracting.</i> The period of time used to determine compliance for a total or partial set-aside contract will be the base term and then each subsequent option period. For an order set aside under a full and open contract or a full and open contract with reserve, the agency will use the period of performance for each order to determine compliance unless the order is competed among small and other-than-small businesses (in which case the subcontracting limitations will not apply).</p> <p>The contracting officer, in his or her discretion, may require the concern to comply with the applicable limitations on subcontracting and the nonmanufacturer rule for each order awarded under a total or partial set-aside contract.</p> <p>Compliance will be considered an element of responsibility and not a component of size eligibility.</p> <p>Work performed by an independent contractor shall be considered a subcontract, and may count toward meeting the applicable limitation on subcontracting where the independent contractor qualifies as a similarly situated entity.</p> |
| 13 C.F.R. § 125.6(f) | N/A | <i>Inapplicability of limitations on subcontracting.</i> The limitations on subcontracting do not apply to: (1) Small business set-aside contracts with a value greater than \$3,500 but not \$150,000, or (2) Subcontracts (except where a prime is relying on a similarly situated entity to meet the applicable limitations on subcontracting). |

| <u>Rule Citation</u> | <u>Prior Rule</u> | <u>New Rule</u> |
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| <i>Identity of Interest Affiliation</i> | | |
| 13 C.F.R. § 121.103(f)(1) | Firms owned by immediate family members are presumed to be affiliated and treated as one party. Presumption of affiliation may be rebutted by showing a clear fracture between the firms. The regulation did not define the types of family relationships that give rise to a rebuttable presumption of affiliation. | SBA amended the regulation to clarify that firms owned or controlled by married couples, parties to a civil union, parents, children, and siblings are presumed to be affiliated with each other if they conduct business with each other, such as subcontracts or joint ventures or share or provide loans, resources, equipment, locations or employees with one another. The presumption can be rebutted by showing a clear line of fracture between the concerns. |
| 13 C.F.R. § 121.103(f)(2) | Firms that are economically dependent through contractual or other relationships are presumed to be affiliated and treated as one party. The regulation did not include a fixed percentage that SBA applies when evaluating this criteria. | SBA added 13 C.F.R. § 121.103(f)(2) to adopt a presumption of affiliation based on economic dependence. Specifically, if a firm derives 70% or more of its revenue from another firm over the previous three fiscal years, SBA will presume that the one firm is economically dependent on the other and, therefore, that the two firms are affiliated. This presumption may be rebutted by a showing that despite the contractual relations with another concern, the concern at issue is not solely dependent on that other concern, such as where the concern has been in business for a short amount of time and has only been able to secure a limited number of contracts. In addition, SBA has clarified that SBA will not find affiliation between two concerns owned by an Indian Tribe, ANC, Native Hawaiian Organization or Community Development Corporation based solely on the contractual relations of the two concerns. |
| <i>Joint Ventures</i> | | |
| 13 C.F.R. § 121.103(h)(3) | Currently, in addition to the exclusion from affiliation given to an 8(a) protégé firm that joint ventures with its mentor for any small business procurement, there is also an exclusion from affiliation between two or more small businesses that seek to perform a small business procurement as a joint venture where the procurement is bundled or large (i.e., greater than half the size standard for a procurement assigned a NAICS code with a receipts-based size standard, and greater than \$10 million for a procurement assigned a NAICS code with an employee-based size standard). | SBA amended the regulation to clarify that a joint venture of two or more business concerns may submit an offer as a small business for a Federal procurement, subcontract or sale so long as each concern is small under the size standard corresponding to the NAICS code assigned to the contract. |

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| Size Recertification | | |
| 13 C.F.R. § 121.103(h)(4) | N/A | SBA amended the regulation to exclude subcontractors that are similarly situated subcontractors, as that term is defined in the new 13 C.F.R. § 125.1, from affiliation under the ostensible subcontractor rule. |
| 13 C.F.R. § 121.404(g)(2)(ii) (D) | N/A | SBA's final rule requires recertification of size following the merger or acquisition of a firm that submitted an offer as a small business concern. In this regard, SBA clarifies that if the merger or acquisition occurs after offer but prior to award, the offeror must recertify its size to the contracting officer prior to award. |
| Size Protests | | |
| 13 C.F.R. §§ 121.1001(a)(1)(i), (a)(2)(i) | Any offeror whom the contracting officer has not eliminated for reasons unrelated to size has standing to file a size protest. | SBA amended the regulation to clarify that any offeror that the contracting officer has not eliminated from consideration for any procurement related reason, such as non-responsiveness, technical unacceptability or outside of the competitive range, has standing to file a size protest. In addition, SBA added a new 13 C.F.R. § 121.1001(b)(11) to clarify that, in connection with eligibility for the SDVO SBC and the WOSB/EDWOSB programs, the Director, Office of Government Contracting, may initiate a formal size determination. |
| NAICS Code Appeals | | |
| 13 C.F.R. § 121.1103(b)(1) | An appeal from a contracting officer's NAICS code or size standard designation must be served and filed within 10 calendar days after the issuance of the solicitation or amendment affecting the NAICS code or size standard. | No change; SBA determined the current timeline for filing a NAICS code appeal is appropriate. |
| 13 C.F.R. § 121.1103(c)(1)(i) | Upon receipt of the service copy of a NAICS code appeal, the contracting officer is required to stay the solicitation. | No change. |
| Nonmanufacturer Rule | | |
| 13 C.F.R. § 121.406 | N/A | SBA amended the regulation to clarify that the limitations on subcontracting and the nonmanufacturer rule do not apply to small business set-aside contracts valued between \$3,500 and \$150,000. |
| 13 C.F.R. § 121.1203 | N/A | The final rule authorizes SBA to grant a waiver to the nonmanufacturer rule for an individual contract award after a solicitation has been issued, provided the contracting officer agrees to provide all potential offerors additional time to respond. |
| 13 C.F.R. § 121.1206 | N/A | SBA has added 13 C.F.R. § 121.1206 to require that contracting officers notify potential offerors of any waivers, whether class waivers or contract specific waivers, that will be applied to the procurement. This notification of a waiver must be contained in the solicitation itself. |

