



Column: Are agencies ignoring SBA's application of the nonmanufacturer rule to resellers of major commercial software?

by Cy Alba, partner, PilieroMazza PLLC

Early last year, on Jan. 26, 2016, the Small Business Administration issued a new requirement that Information Technology Value-Added Resellers ("ITVARs"), under the footnote/exception to NAICS Code 541519, have to comply with the nonmanufacturer rule when reselling software under that code.

Thus, according to the rule, any ITVAR must provide software that is manufactured (i.e., developed) by a small business unless a waiver of the nonmanufacturer rule is requested by the contracting officer and granted by SBA for each and every ITVAR procurement.

While certain hardware has a blanket waiver to the nonmanufacturer rule's small business sourcing mandate, there is no such waiver for software.

That being said, after talking with numerous executives of ITVARs, it appears many are not even aware of the rule change or what the nonmanufacturer rule is or means, much less that ITVAR work under NAICS Code 541519 must comply with the rule.

Lack of awareness

It has been a year since SBA promulgated the final rule making the nonmanufacturer rule applicable to ITVAR contracts, yet, after all this time, this lack of awareness in the industry is still widespread.

Additionally, agencies seem happy to ignore SBA's regulatory mandate.

In some cases, agencies are standing on solid legal ground by using contract vehicles such as NASA SEWP, which was issued prior to the January 2016 rule change, so the new rule does not apply to those contract holders.

In other cases, however, it appears that agencies are simply ignoring nonmanufacturer compliance questions and turning a blind eye to noncompliance.

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While this may seem like it is beneficial to both the small business contractors and the government, there is a real risk that contractors engaging in the provision of software and even certain hardware, under ITVAR procurements, are making false small business certifications at the time they bid on the procurements and each time they submit an invoice for payment under those contracts.

Risks of false certifications

Given this risk, contractors should understand that, if a small business contract is awarded based upon a false statement, the Small Business Act states that it is implied that the false certification was made willfully.

Such an implication is important because, under the False Claims Act, any false statement made willfully or with reckless disregard of the truth creates liability under said Act.

Even more importantly, should liability be found under the False Claims Act, any other amendment to the Small Business Act presumes the loss to the government to be the full value of the awarded contract (an amount which can be tripled as a penalty for a willfully false statement – which is presumed as noted above).

Thus, a small business that receives an ITVAR contract valued at \$1 million and submits its proposal never intending to comply with the nonmanufacturer rule,

perhaps because the company does not understand the rule or realize it exists, can be found to have willfully submitted a false statement and be subject to \$3 million in damages plus statutory penalties of \$22K per invoice submitted under the contract.

All this for a contract where most of the \$1 million were pass-through revenues to the Original Equipment Manufacturer and the profit margin is not large.

Work together to change rule

It is for these reasons that small business must be aware of SBA's 2016 rule change and ITVARs must take the change seriously.

While I believe most would agree that the rule change is highly detrimental to the entire viability of the small business ITVAR industry, the rule is in effect and must be followed unless and until Congress or SBA revise the rule and correct what is clearly a harmful change.

To that end, ITVARs should work together to change this rule or band together to provide alternatives to the now onerous nonmanufacturer waiver process. Hopefully, the small business community can coalesce to take up this issue before the first ITVAR finds itself within the scope of the Department of Justice or SBA. Set-Aside Alert has certainly reported on the issue in the past to raise awareness but it seems like many companies are still unaware of the rule or its implications.

Cy Alba is a partner with PilieroMazza PLLC in the Government Contracting Group. For over 25 years, PilieroMazza has helped businesses to successfully navigate a diverse array of legal matters, including government contracting, SBA's procurement programs, litigation, labor and employment and corporate law. Visit www.pilieromazza.com.