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SBA'S PROPOSED CHANGES TO THE LIMITATIONS ON SUBCONTRACTING



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PRESENTED BY

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OVERVIEW

- Hot off the presses: SBA's proposed rule for the new mentor-protégé program for all small businesses
- How the limitations on subcontracting currently work
- Changes to the limitations on subcontracting in the 2013 National Defense Authorization Act (NDAA)
- SBA's proposed rules to implement the 2013 NDAA and make several other changes to its small business rules
- Questions



**SBA'S PROPOSED RULE TO ESTABLISH
A MENTOR-PROTÉGÉ PROGRAM
FOR ALL SMALL BUSINESSES**



NEW MENTOR PROTÉGÉ PROGRAM

- Proposed rule issued February 5, 2015
- Comments due April 6, 2015
- Would create one new mentor-protégé program open to all small businesses
 - Would allow all small business protégés to joint venture with their large business mentors
 - Mentors could own up to 40% of protégé
 - Proposed participation period: no more than two consecutive three-year terms (total of six years)
 - SBA must conduct a formal size determination before a firm would be an eligible protégé
 - May signal end of many other federal mentor-protégé programs
 - Only for-profit firms would qualify as mentors
 - Relaxed requirements for protégés = simply need to be small



OTHER PROPOSALS IN THE MENTOR-PROTÉGÉ RULEMAKING

- Several proposed changes to joint venture rules:
 - No more populated joint ventures
 - SBA may require all mentor-protégé joint ventures to be formed as a separate legal entity
 - Proposal contains some inconsistencies regarding how joint venture partners must share profit and would qualify as small
 - Joint ventures would be required to submit a certification of compliance, would be subject to suspension/debarment for noncompliance
 - 8(a) joint ventures would be subject to size protests
 - HUBZone firms may joint venture with non-HUBZone firms
- SBA wants ability to disregard claim of disadvantage for 8(a) eligibility if applicant has not presented evidence to disprove a “legitimate alternate ground” for perceived discrimination



CHANGES TO THE LIMITATIONS ON SUBCONTRACTING RULE



LIMITATIONS ON SUBCONTRACTING – CURRENT REQUIREMENTS

- Current rules vary by program set-aside type, and whether acquisition is for services, general construction, or trade construction
- Limits the amount of labor costs that can be subcontracted
 - For services, SB must perform at least 50% of the cost of the contract incurred for personnel with its own employees
 - For supplies or products, SB must perform at least 50% of the cost of manufacturing the supplies or products (not including the costs of materials)
 - For general construction, SB must perform at least 15% of the cost of the contract with its own employees (not including the costs of materials)
 - 25% for specialty trade contractors
- Excludes profit or fees from the cost of the contract and includes only labor costs (base of direct labor plus G&A rate multiplied by the labor cost)
- SDVOSBs and HUBZone firms can satisfy requirement through combination of their own employees and subcontracts to other SDVOSB or HUBZone firms



CHANGES IN THE 2013 NDAA

- Section 1651 of the 2013 NDAA changed the limitations on subcontracting for supply and services contracts to be based on the total cost of the contract, not the cost of the contract incurred for personnel
 - For service contracts, SB “may not expend on subcontractors more than 50 percent of the amount paid to the concern under the contract”
 - For supply contracts, SB “may not expend on subcontractors more than 50 percent of the amount, less the cost of materials, paid to the concern under the contract”
 - Construction not addressed; left to SBA rulemaking
- Law envisions that SBA can change the performance percentage for a particular industry to reflect conventional industry practices among SBs in that industry



CHANGES IN THE 2013 NDAA (CONT'D)

- Law permits SBs to satisfy the limitations on subcontracting through the combination of the SB's work on the prime contract and any subcontracts to “similarly situated entities”
 - Similarly situated = a firm that qualifies for the same small business status required for the prime contract
 - Example: For an 8(a) set-aside contract for services, the 8(a) prime contractor could satisfy the limitations on subcontracting through a combination of its own work (30%) and subcontracts to other 8(a) firms (20%), but a subcontract to a HUBZone firm or an SDVOSB would not count



SBA'S PROPOSED RULE TO IMPLEMENT THE 2013 NDAA



OVERVIEW OF THE PROPOSED RULE

- Released December 29, 2014
- Comments are due February 27, 2015
- Proposal would implement the 2013 NDAA changes to the limitations on subcontracting
- Proposal would also make a number of other changes to SBA's small business rules, including:
 - Identity of interest affiliation
 - Joint ventures
 - Subcontracting plan requirements
 - Nonmanufacturer rule



NEW LIMITATIONS ON SUBCONTRACTING PROVISIONS

- Proposed rule keeps the same percentages, but now the percentages are based on total contract value:
 - 50% for services
 - 50% for supplies
 - 15% for general construction
 - 25% for specialty trade construction



MIXED SERVICE & SUPPLY CONTRACTS

- For contracts that involve both services and supplies, the CO must select the appropriate NAICS code, which will be a services or manufacturing code depending on which constitutes the majority of the contract value
- The selected NAICS code will determine which limitation on subcontracting applies – either for services or supplies
 - Proposed rule makes clear that in no case would the limitations on subcontracting for services and supplies apply to the same contract
- The applicable limitation on subcontracting (either for services or supplies) “shall apply only to that portion of the contract award amount”
 - This appears to mean that on a contract primarily for services, you can exclude any supplies and apply the “50% of the total cost of the contract” subcontracting limitation to only the services portion of the contract



SBA EXAMPLE FOR MIXED SUPPLIES AND SERVICES CONTRACT

- “A procuring agency is acquiring both services and supplies through a small business set aside. The total value of the requirement is \$3,000,000, with the supply portion comprising \$2,500,000, and the services portion comprising \$500,000. The contracting officer appropriately assigns a manufacturing NAICS code to the requirement. Because the services portion of the contract is excluded from consideration, a small business manufacturer, together with one or more similarly situated small business manufacturers, must perform at least 50% of the cost of manufacturing the supplies or products, or at least 50% of the \$2,500,000 supply portion of the requirement (not including the costs of materials).” (Emphasis added)



CONSTRUCTION CONTRACTS

- Proposed rule does not exclude cost of supplies or materials for construction contracts, meaning such costs would be included in the total contract value
- If the proposed rule is adopted, the existing percentages of 15% and 25% will be unworkable for many small business construction projects
- Why not keep the exclusion for the cost of materials found in the existing construction rule?
 - 2013 NDAA gave SBA freedom to implement rules for construction, so it does not have to change the existing rule
 - 2013 NDAA includes an exclusion for the cost of materials on supply contracts, so why not for construction as well?
 - Note: SBA's proposed rule includes the cost of materials exclusion for supply contracts in an example, but the text of the rule itself omitted the exclusion – SBA will need to fix this in the final rule



SIMILARLY SITUATED ENTITIES

- Any work done by a similarly situated SB will not constitute “subcontracting”
- A similarly situated entity is another SB that is a participant of the same small business program that the prime contractor is a certified participant of and which qualified the prime contractor to receive award
- Both the Prime SB and its similarly situated subcontractors must perform the required amount of work “themselves” – i.e., similarly situated subcontractor may not flow down work to large business subcontractors
 - But work performed by similarly situated entities at any tier will count towards applicable subcontracting percentage
- Similarly situated entities also excluded from ostensible subcontractor affiliation considerations



SIMILARLY SITUATED ENTITIES (CONT'D)

- When utilizing similarly situated entities, the proposed rule would require the prime contractor to identify the similarly situated entities in its proposal
- Percentage of the prime contract award amount that will be spent on each similarly situated entity must be identified in a written agreement with the similarly situated entity
 - A written agreement is required for each similarly situated entity and must include the solicitation number, must be signed by both parties, and must be attached to the prime contractor's proposal
- Not material whether the specific entities identified in proposal actually end up performing the exact amount of work, so long as collectively all the entities are meeting applicable subcontracting target



COMPLIANCE

- Compliance will be an element of responsibility and not a component of size eligibility (i.e., no size protests)
- Prime SB must certify its compliance with the applicable limitation on subcontracting with its proposal
 - If it is not apparent on face of offer that the prime contractor will meet the applicable subcontracting limitation on the date of award, the CO may request a Certificate of Competency from SBA
 - The certification requirement opens potential suspension/debarment and other liability, if false
 - Is the CO's failure to determine compliance or failure to refer to SBA for a COC a protestable issue at the GAO?
- If prime contract award amount is modified after award, prime contractor must notify the CO if it is no longer able to meet applicable limitation on subcontracting



COMPLIANCE (CONT'D)

- Time period used to determine compliance for a total or partial set-aside would be the base term and then each subsequent option period
 - CO has discretion to require compliance for each order
- For an order under a full and open contract, the time period will be the period of performance for each order
 - Unless the order is competed amongst small and other-than-small businesses, in which case the limitations on subcontracting will not apply
- Small Business Teaming Arrangements (SBTAs) = compliance measured on cooperative effort of all team members, not efforts of the individual members



COMPLIANCE (CONT'D)

- Limitations on subcontracting do not apply to small business set-aside contracts between \$3,000 and \$150,000 or subcontracts
 - However, for subcontracts to similarly situated entities, the similarly situated entity must perform the required portion of the work itself
- Penalties for noncompliance would include a fine equal to the greater of \$500,000 or the dollar amount of subcontracting spent in excess of the permitted level



PROCEDURES FOR CHANGING THE LIMITATION FOR A SPECIFIC NAICS CODE

- SBA is proposing procedures for industry groups or interested small businesses to request the SBA Administrator to change the subcontracting percentage requirements by six-digit NAICS codes
- The request must demonstrate that the change is necessary to reflect industry practices among small businesses in that NAICS code
- The proposed rule cites examples of information that should be submitted
- For SBA to grant such a request, it must go through a rulemaking process, i.e., public notice and opportunity for comment



CONCERNS WITH THE PROPOSED RULE

- ❑ Limitation on subcontracting for supply contracts missing statutory exclusion for cost of materials
- ❑ Why is SBA allowing a firm to exclude supplies from a predominantly services contract, but it has provided no exclusion for construction contracts?
- ❑ Difficult practical implications
 - ❑ Percentages for construction too high if no exclusion for materials
 - ❑ In some industries, it will be very difficult to identify subcontractors in the proposal, especially IDIQ task order contracts where precise requirements and timeline may be unknown at proposal stage
- ❑ Potential for false certifications, as well as affiliation with similarly situated entities despite no ostensible subcontractor affiliation
- ❑ Agencies need to ensure RFPs do not restrict ability to rely on past performance of similarly situated subcontractors



OTHER PROPOSED RULE CHANGES IN THE LIMITATIONS ON SUBCONTRACTING RULEMAKING



SB SUBCONTRACTING PLANS

- Head of contracting agency must ensure agency collects, reports, and reviews data on the extent to which prime contractors meet the goals and objectives of their subcontracting plans
- Penalties for not providing a written corrective action plan or demonstrating good-faith effort to comply with such a plan:
 - May be considered for liquidated damages under FAR § 52.219-16
 - Material breach of contract
 - Must be considered in any past performance evaluation
 - Referral to SBA IG if contractor makes a false statement about plan
- Before prime identifies SB by name as a subcontractor in its proposal or subcontracting plan, prime must notify SB in writing



AFFILIATION

- Two proposed changes for identity of interest affiliation:
 - Rebuttable presumption of identity of interest affiliation through family relationships exists for firms that conduct business with each other and are owned and controlled by persons who are married, parties to a civil union, parents and children, or siblings
 - Other family relationships not mentioned in the rule would not be grounds for identity of interest affiliation
 - Rebuttable presumption of affiliation through economic dependence when one firm derives 70% or more of its revenue from another firm over the previous completed fiscal year
 - Currently, there is no fixed percentage that leads to affiliation based on economic dependence, but case law has adopted 70%
 - May be rebutted when a firm is new or a start-up and has only received a few contracts or subcontracts
 - What if current, incomplete fiscal year shows trend away from economic dependence?



JOINT VENTURES

- SBA is proposing to permit two or more small businesses to joint venture for any procurement, as long as each firm is considered to be small for the procurement
- Generally, joint venture partners are considered to be affiliated for the contract they pursue, meaning the partners' combined revenues or employees must be below the applicable small business size standard
 - Currently, there is an affiliation exception when a joint venture pursues a bundled or large procurement (i.e., greater than half the size standard for a procurement with a receipts-based size standard, or greater than \$10 million for a procurement with an employee-based size standard)
 - SBA's proposed rule would expand the affiliation exception to any procurement, regardless of size



SIZE RECERTIFICATION

- Existing rule: small businesses must recertify their size on existing set-aside contracts when they undergo a merger or acquisition
- The proposed rule would require firms to recertify size to the contracting officer on pending proposals where the merger or acquisition occurs after proposal submission but prior to award
 - How will recertification in this circumstance affect the agency's willingness to award the contract to that firm?
 - Is SBA moving toward requiring all small businesses to be eligible at the time of proposal submission and the time of award?
 - Also, proposal does not address the fact that the current regulations only require recertification if the firm is purchased by another company, as opposed to by an individual



NAICS CODE APPEALS

- An interested party may challenge the NAICS code assigned to a solicitation by filing an appeal with SBA's Office of Hearings and Appeals
 - Currently, an appeal must be filed within 10 calendar days after issuance of the solicitation or amendment affecting the NAICS code
 - SBA is seeking comment on whether 10 days is the appropriate timeline, in light of the fact that many procurements close in less than 30 days
- SBA is also assessing the impact a NAICS code appeal should have on the solicitation in question
 - Currently, SBA's regulations require the CO to "stay the solicitation"
 - SBA is seeking comments on whether its rules should provide that the CO should not award the contract or delay the offeror or bid response date (Yes!)



NONMANUFACTURER RULE

- SBA is proposing to clarify that the limitations on subcontracting and the nonmanufacturer rule do NOT apply to small business set-aside contracts between \$3,000 and \$150,000
 - Expected to spur more small business set-asides because agencies will not need to request a waiver of the nonmanufacturer rule, and small businesses will be able to supply products manufactured by large businesses (such as computers and other “name brand items”)
 - Exception only applies for small business set-asides; limitations on subcontracting would continue to apply to 8(a), HUBZone, SDVOSB, and WOSB/EDWOSB set-asides between \$3,000 and \$150,000



NONMANUFACTURER RULE (CONT'D)

- Proposed changes to waivers of the nonmanufacturer rule:
 - COs would be required to notify potential offerors in the solicitation as to whether a class waiver or an individual waiver is applicable to the procurement
 - SBA would be authorized to grant a waiver for an individual contract award after the solicitation has been issued, as long as the CO gives all potential offerors additional time to respond
 - SBA would also be authorized to grant waivers after contract award when additional items that are waiver-eligible are sought through an in-scope modification
 - Clarification that waiver of the nonmanufacturer rule does not exempt the contractor from complying with other requirements pertaining to the supplied item, such as the Buy American Act and the Trade Agreements Act



SOFTWARE PURCHASES

- Nonmanufacturer rule would apply to certain software that can readily be treated as an item rather than a service
 - Readily-available software that is generally available to both the public and private sector unmodified
 - Change would allow SBA to grant waivers of the nonmanufacturer rule for such software, permitting small businesses to supply the software on set-aside contracts
 - Agencies should use NAICS code 511210 when purchasing software eligible for a waiver
- Change would not affect contracts for the creation or modification of custom-design software
 - SBA will continue to treat such software as a service, requiring small business (together with similarly situated entities) to perform the required percentage of the work



THE ROTECH DECISION

- SBA's view is that the nonmanufacturer rule applies when supplies constitute the primary purpose of the project, but not when a primarily services contract includes some ancillary supplies
- On September 19, 2014, U.S. Court of Federal Claims' Rotech decision held that the plain language of the nonmanufacturer rule in the Small Business Act applies to "any" supplies being procured via small business set-asides
 - Meaning, even supplies procured as an ancillary part of a services or construction contract must be obtained from a small business manufacturer, unless SBA grants a SBA waiver
 - DOJ decided not to appeal Rotech
- Proposed rule confirms SBA's view that the CO's selection of a NAICS code will determine whether the contract is subject to services or supply limitation on subcontracting



Questions?



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