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VIA FEDERAL RULEMAKING PORTAL

Brenda Fernandez
Office of Policy, Planning and Liaison
U.S. Small Business Administration
409 Third Street SW
Washington, D.C. 20416

Re: RIN 3245-AG86, Proposed Rule
National Defense Authorization Acts of 2016 and 2017, Recovery Improvements for Small Entities After Disaster Act of 2015, and Other Small Business Government Contracting

Dear Ms. Fernandez:

We are writing to submit comments on the U.S. Small Business Administration's ("SBA") above-referenced proposed rule on amendments to its regulations to implement several provisions of the National Defense Authorization Acts of 2016 and 2018 and the Recovery Improvements for Small Entities After Disaster Act of 2015 ("RISE Act"), as well as other clarifying amendments. 83 Fed. Reg. 62516. Our firm represents small businesses and their teaming and joint venture partners operating across the government contracting spectrum. Although many of SBA's proposed changes are welcome to the small business contracting community, we believe that several of the proposed rules will create confusion and compliance challenges for small business contractors. Our comments to key proposed changes are below.

- **SBA's Proposed Changes About Subcontracting Plans Provide Necessary Clarification**

The proposed changes to Section 125.3 about small business subcontracting plans provide helpful clarification and greater protection for small business subcontractors under small business subcontracting plans. The examples of what constitutes a large business prime contractor's "good faith effort to comply with its subcontracting plan" are helpful in confirming what a small business subcontractor can expect from a large business prime contractor that is making a good faith effort to comply with its subcontracting plan, such as paying its small business subcontractors as agreed in the subcontract. These examples also help prime contractors know whether they are meeting their subcontracting plan obligations, even if they are falling short on their subcontracting numbers. For example, if the prime contractor has failed its goal in one socioeconomic category but overreached its goal in another category by an equal or

greater amount, it can take comfort in knowing that it has made a good faith effort to comply with its subcontracting plan.

The examples of what constitutes a failure to make a "good faith effort to comply with a subcontracting plan" also are helpful for large business prime contractors, so they know what will constitute a breach of their subcontracting plan obligations. Having these clear examples will enable prime contractors to know what minimum standards they need to exceed to avoid being found in breach of their subcontracting plan obligations. These clear examples will also help small businesses because they will make it easier for agencies to keep large business prime contractors accountable for their subcontracting plans. SBA noted that it "is not aware of any case where a firm has been subject to liquidated damages for failure to comply with a subcontracting plan." In our experience, not all large business prime contractors comply with their subcontracting plans, and they should be held accountable when they fail to make a good faith effort to comply with their subcontracting plans. By having clear examples of what constitutes that failure to comply in good faith with a plan, agencies can more easily determine whether their large business prime contractors have materially breached their subcontracting plan obligations.

Additionally, SBA's proposed change to commercial subcontracting plans is welcome. SBA proposes to clarify that a contractor using a commercial subcontracting plan must include all indirect costs in its subcontracting goals and its summary subcontracting report ("SSR"). As SBA noted, the current rules created inconsistency between a contractor's commercial subcontracting plan and its SSR with respect to how to count indirect costs. The proposed rule corrects the inconsistency and provides greater clarity for how large businesses will create and report on their commercial subcontracting plans.

- **SBA's Contracting Preferences for Small Businesses in Disaster Areas Are Welcome**

SBA has proposed to implement Section 2108 of the RISE Act by adding a new part 129 to title 13 of the Code of Federal Regulations. This addition will benefit small businesses by providing agencies with an incentive to set aside contracts for small business concerns ("SBC") located in a disaster area. Specifically, if an agency awards an emergency response contract to a local SBC through the use of a local area set-aside that is also set aside under a small business or socioeconomic set-aside, the value of the contract shall be doubled for purposes of determining compliance with its contracting goals. This, in turn, will benefit small businesses in the disaster areas by providing employment and revenue to concerns located in the disaster area. While the concept of local area set-asides is not new, we support SBA's decision to give agencies double credit for its emergency response contracts to small businesses because it should create more opportunities for small businesses located in disaster areas.

❖ **SBA's Clarification Regarding the Nonmanufacturer Rule and Information Technology Value Added Resellers Is Beneficial**

Previously, there has been confusion surrounding the applicable size standard in acquisitions that have been assigned the information technology value added reseller ("ITVAR") exception to NAICS code 541519. Among other requirements not relevant here, generally, a firm may qualify as a nonmanufacturer if it does not exceed 500 employees. However, under NAICS code 541519, footnote 18 of 13 C.F.R. § 121.201, the size standard applicable to the ITVAR exception of NAICS code 541519 is 150 employees. SBA's Office of Hearings and Appeals ("OHA") recently denied an appeal where a firm tried to argue that the size standard under the ITVAR exception was 500 employees, as opposed to 150 employees. While SBA previously clarified that the nonmanufacturer rule applies to procurements that have been assigned the ITVAR exception to 541519, the proposed rule further clarifies that the nonmanufacturer rule size standard of 500 employees does not apply to acquisitions that have been assigned the ITVAR NAICS code 541519 exception, footnote 18. Rather, the size standard of 150 employees applicable to the ITVAR exception is applicable. As this proposed addition simply further clarifies the size standard for ITVAR procurements, we support this clarification.

❖ **Setting Aside an Order Under a Multiple-Award Set-Aside Contract**

SBA has requested comments on whether it should amend 13 C.F.R. § 125.2(e)(6)(i) to allow agencies to set aside orders for a socioeconomic small business program (e.g., 8(a), HUBZone, Service-Disabled Veteran-Owned ("SDVO"), and Woman-Owned Small Business ("WOSB")) under a multiple-award contract that was originally conducted as a total small business set-aside. For the reasons outlined below, we do not believe SBA should implement this proposed change.

As an initial matter, it is important to note that the Federal Acquisition Regulation coverage of order set-asides, which predates SBA's multiple-award contract rule, 78 Fed. Reg. 61114 (Oct. 2, 2013), does not specifically contemplate set-asides within set-asides. See 76 Fed. Reg. 68032 (Nov. 2, 2011). Moreover, SBA has expressly declined to implement such a rule in the past for two discrete reasons. First, SBA was concerned that it would be difficult for SBCs and agencies to determine the rules that applied to a particular order because "the small business programs had major differences with respect to application of the limitations on subcontracting (LOS) and [Nonmanufacturer Rule (NMR)]." 83 Fed. Reg. 62516, 62518 (Dec. 4, 2018). Second, "SBA was also concerned about the possibility that SBCs could be deprived of an opportunity to compete for orders under a set-aside contract if an agency repeatedly set aside orders for other socioeconomic categories." Id. (emphasis added). These concerns were well-founded. And, we do not agree with SBA's conclusion that the proposed rule can now be implemented because SBA "standardized the LOS and NMR across the socioeconomic programs." Id. Indeed, standardization of the LOS and NMR only addresses SBA's first

concern listed above. However, it does nothing to mitigate the proposed rule's adverse impact on the ability of SBCs to compete for and receive orders.

More specifically, we believe that allowing agencies to set aside orders for certain socioeconomic categories under multiple-award contracts that have been set aside for a broader socioeconomic category would be unfair to the SBCs that originally competed for and obtained the multiple-award contract, but are ineligible to compete for the narrower task order set-aside. Generally speaking, multiple-award contracts offer a number of benefits to the government and contractors by, among other things, streamlining the ordering process and narrowing the field for future task order competitions. Accordingly, companies expend significant time and resources procuring these contracts, with the understanding that they will be afforded an opportunity to compete against a limited field of contract holders for future work. The proposed rule, however, would upset this balance and could greatly diminish the value of multiple-award contracts.

As a limited example, assume an agency awards a multiple-award contract as an SBC set-aside with $ 1 billion in potential work. As noted above, an SBC's decision to invest in pursuing this multiple-award contract would rest on its opportunity to compete against other SBC contract holders for the $1 billion in potential work. If, however, the proposed rule is adopted, after awarding the multiple-award contract, the procuring agency could begin arbitrarily conducting narrower set-asides at the task order level. As a result, the actual amount of work any given SBC contract holder would be eligible to compete for could be significantly less than $1 billion. In fact, it may not even come close to that figure. In other words, under the proposed rule, the amount of potential work available to a multiple-award contract holder would be inherently unpredictable. This type of unpredictability would create a situation whereby, unless an SBC possessed one or more additional socioeconomic statuses, it would have no incentive or, at least, a much smaller incentive to compete for a multiple-award contract set aside for SBCs.

The proposed rule would also make it extremely difficult for contractors to determine the value of a multiple-award contract because the potential work available under such a contract would be extremely speculative. Given this uncertainty, competition for multiple-award contracts could significantly diminish if the proposed rule is implemented. Decreased competition for multiple-award contracts would also impact the government's ability to procure the most cost-effective solutions. As a result of these unintended consequences, the proposed rule could actually hinder rather than promote small business contracting. For these reasons, we do not believe the proposed rule should be adopted.

That being said, if SBA decides to implement the proposed rule, it should be modified in a number of respects. First, we do no believe agencies should simply be allowed to establish set-asides to socioeconomic programs at the order solicitation level under multiple-award small business set-aside contracts. Instead, we believe the procuring agency should be required to disclose whether it will conduct narrower task order set-aside competitions in the multiple-award contract solicitation. And, if the agency intends to conduct such competitions, its disclosure

should include goals for each socioeconomic small business program, akin to a small business subcontracting plan. In addition, in order to implement its goals with greater transparency, the agency should be required to establish socioeconomic set-aside pools at the master contract solicitation level. Eligibility for these pools should be determined at that time, and contracting officers ("CO") should not be given the discretion to request recertification of either size or status in connection with specific orders. Taken together, we believe these changes would give potential bidders on a multiple-award contract a greater ability to analyze the value of the contract and to understand the potential opportunities available thereunder.

Second, we believe the proposed rule needs to be revised to ensure that agencies are only permitted to set aside orders for a socioeconomic small business program under a multiple-award contract that was either conducted using full and open competition or was awarded as a total small business set-aside. As drafted, the proposed rule would permit agencies to set aside orders for a socioeconomic small business program under <u>any</u> multiple-award contract. Indeed, the proposed rule provides as follows:

> (i) Notwithstanding the fair opportunity requirements set forth in 10 U.S.C. 2304c and 41 U.S.C. 253j, the contracting officer has the authority to <u>set aside orders against Multiple Award Contracts</u>, including contracts that were set aside for small business. This includes order set asides for 8(a) Participants, HUBZone SBCs, SDVO SBCs and WOSBs.

83 Fed. Reg. 62516, 62529 (Dec. 4, 2018) (emphasis added). Under to the foregoing language, an agency could set aside an order for 8(a) participants under a multiple-award contract that was awarded as a HUBZone set-aside. We do not believe this was SBA's intent, as it would essentially allow a procuring agency to use any multiple-award contract to achieve any of its small business program goals. In addition, for the same reasons outlined above, such a rule would disadvantage contract holders that qualified for the multiple-award contract-level set-aside, but are not eligible to compete for the narrower task order set-aside.

In sum, we do not believe SBA should implement this proposed rule because it would hinder the ability of SBCs to compete for and win orders under their SBC set-aside multiple-award contracts, which they expended significant time and resources to procure. However, if SBA chooses to adopt this rule, it should, at a minimum, implement the revisions proposed above.

- **SBA Should Provide Further Clarifications to Its Proposed Rule on Recertification of Size and Status**

The proposed rule would require concerns to recertify their size and status on full and open contracts, not just set-aside awards. The proposed rule's preamble does not fully clarify

what the intent behind this change is, but it appears that it is meant to limit a procuring agency's ability to take small business and socioeconomic credit for orders awarded to contractors that represented their small business size or socioeconomic status for a full and open indefinite-delivery, indefinite-quantity ("IDIQ") contract. To the extent that these recertification requirements mirror the existing ones for set-aside procurements, we believe that this change makes sense. SBA should perhaps clarify its intent by making it clear that such recertification is only required for those contracts where the concern had certified its size or status to the procuring agency and the agency is taking small business or socioeconomic credit for the award.

SBA has also proposed to add recertification requirements for 8(a) participants and small disadvantaged business ("SDB") concerns, which are already present in the SDVOSB, HUBZone, and WOSB regulations. While we applaud SBA's steps towards creating uniformity in the regulations, we would point out that the SDB regulations do not contemplate SDB set-aside contracts. We believe the language of this regulation should be clearer when explaining that its application applies only in those situations where the procuring agency is taking SDB credit for the contract.

We also have concerns regarding the revised 8(a) recertification requirements. As SBA states, its intent is to provide uniformity amongst the recertification regulations applicable to the various socioeconomic programs. However, the 8(a) regulations already have a unique set of requirements found in 13 C.F.R. § 124.503(h), which govern the ability for orders issued under multiple-award contracts to be accepted into the 8(a) program. This regulation distinguishes between multiple-award contracts set aside for exclusive competition amongst 8(a) participants, multiple-award contracts that were not set aside for exclusive competition among eligible 8(a) participants, and reserves. Key in the determination of whether SBA will consider a task order issued under a multiple-award contract that is not exclusively competed amongst 8(a) participants as an "8(a) contract" is whether or not the awardee is a current participant in the 8(a) program. 13 C.F.R. § 124.503(h)(2)(iv). This rule heavily impacts contractors that represent 8(a) status upon award of a General Services Administration ("GSA") Schedule contract (which is defined as a multiple-award contract), because GSA Schedules are not competed exclusively amongst 8(a) participants—under SBA's current rules, once they are no longer participants in the 8(a) program, these firms are not able to compete for 8(a) set-aside task orders, even though they have represented their 8(a) status at the Schedule-contract level.

It is unclear how the requirements of 13 C.F.R. § 124.503(h) square with SBA's proposed rule regarding 8(a) recertification, which states that "[g]enerally, a concern that represents itself and qualifies as an 8(a) Participant at the time of initial offer (or other formal response to a solicitation), which includes price, including a Multiple Award Contract, is considered an 8(a) Participant throughout the life of that contract." Proposed 13 C.F.R. § 124.521(e)(1) (emphasis added). Because there are many multiple-award contracts that were not exclusively competed amongst 8(a) concerns (such as GSA Schedules), we believe that SBA needs to harmonize its proposed 8(a) recertification rule with the requirements of the existing 13 C.F.R. § 124.503(h).

The proposed recertification rule also emphasizes that a prime contractor relying on a similarly situated subcontractor may not count the subcontractor towards its performance requirements if the subcontractor recertifies as an entity other than that which it had previously certified. However, the rule does not specify when the subcontractor is required to recertify. Unlike the recertification rules governing prime contractors, SBA's current regulations do not require subcontractor recertification upon certain "triggering" events such as merger or acquisition. The proposed regulations do not provide similar "triggering" events for subcontractor recertification, so it is unclear to whom the subcontractor is supposed to recertify and how compliance will be enforced.

Additionally, we believe SBA should amend the proposed 13 C.F.R. § 124.521(e)(1)(i). As drafted, this regulation would require an 8(a) firm to comply with 13 C.F.R. §§ 124.105(i) and 124.515 "where the concern performing the 8(a) contract is acquired by, acquires, or merges with another concern . . ." (emphasis added). As drafted, SBA is requiring an 8(a) company that is acquiring or merging with another concern to apply to SBA for approval of its "change of ownership" (section 124.105(i)), even though there has been no change of ownership for the acquiring concern. More perplexingly, the acquiring firm would also be required to undergo the contract waiver provisions found at section 124.515 for its own 8(a) contracts, even though novation of these contracts is not required. Therefore, we suggest that SBA strike the word "acquires" from its proposed 13 C.F.R. § 124.521(e)(1)(i).

Similarly, we believe there is an error in SBA's proposed 13 C.F.R. § 124.521(e)(1)(ii). The proposed language says "[w]here an 8(a) Participant receives a non-8(a) contract that is novated to another business concern, the concern that will continue performance on the contract must certify its status as an 8(a) Participant to the procuring agency. . ." (emphasis added). We believe SBA means "8(a) contract," not "non-8(a) contract," as the firm's 8(a) status would not be relevant for a non-8(a) contract award. If SBA's intent is to prevent procuring agencies from continuing to receive 8(a) credit for options and orders placed under full and open contracts where the awardee had represented its 8(a) status and the contracting agency is taking 8(a) credit, then SBA should clarify that such 8(a) recertification is only required where an 8(a) representation has been made and the procuring agency is taking 8(a) credit for the work.

SBA should limit contracting officials' discretion to require recertification of 8(a) status in connection with task orders issued under 8(a) IDIQ contracts. The intent of the 8(a) program is to aid and assist firms that are socially and economically disadvantaged. When these firms invest resources, including significant investments of time and expense, in competing for large contract vehicles, upon award they should then be able to compete for all task orders for which they are otherwise qualified and eligible. Contracting officials should not have the authority to limit the ability of former 8(a) participants to fully maximize the value of their investment on IDIQ contract vehicles.

Finally, we note that SBA's recertification requirements complicate the general rule by creating exceptions that require offerors to recertify their small business size status when a contractor has undergone a contract novation, merger, sale, or acquisition. Since the establishment of the recertification rule, short-term, single-award procurements have declined in most industries, replaced by large, longer-term multiple-award contracts. Many of these multiple-award contracts are set aside under the small business programs or have reserves or partial set-asides. While these contracts are, in and of themselves, valuable vehicles for the successful small business contract awardees, they also can result in small businesses prematurely exceeding size standards, as the task order awards tend to be large and one or two task order awards can cause a business to be other than small. While no recertification is required under the recertification rules due to natural growth of the company, winning several task orders under these vehicles may prevent the company from bidding on future small business solicitations if it has exceeded the size standard. In addition, allowing COs the discretion to request recertification on task orders under these vehicles has the unintended effect of locking out vehicle holders that have successfully utilized the vehicle and are no longer small under the size standard.

These small business companies may find themselves prohibited from bidding under the vehicles that they competed for and won and also from competing for new work as a small business. These companies are stuck in a very bad place. They cannot continue to bid as small for new work; they cannot bid on their multiple-award contracts if the CO requests recertification at the task order level; and yet, they are not large enough to compete in the unrestricted marketplace.

Moreover the requirements for recertification upon merger or acquisition have a debilitating impact on a company to buy or sell if either seller, purchaser, or both have small business set-aside contracts. Once a company has recertified as other than small, the regulations require the ordering agencies to "no longer count the options or orders issued pursuant to the contract, from that point forward, towards its small business goals." 13 C.F.R. § 121.404(g)(2)(i). This requirement devalues the previously valuable multiple-award contract, which jeopardizes the contractor's ability to engage in the merger and acquisition marketplace.

Small businesses that have recently become other than small or that anticipate that happening in the near future often have few choices. They can slug it out in the unrestricted marketplace and, if they fail, may revert to being a small business again, or they can seek to become more competitive through a sale or an acquisition. However, SBA's rules again stifle this free-market thinking, since both buyer and seller risk losing their contracts if, post-transaction, they cannot certify as small. While the rule may not have had such a devastating effect in 2004 when single-award contracts were more commonplace, in today's market, where small businesses are multiple-award contract holders and forced to compete for each task, maintaining a small business status is critical.

While we understand that it may be against SBA policy for very large firms to benefit from small business set-asides (except for SBA-approved mentors), that policy must be weighed against current market conditions and the desire for small businesses to successfully transition into mid-sized firms. Having the ability to continue to bid on your backlog, whether you have been awarded a short- or long-term contract or a single or multiple-award contract, you should not be impacted by business decisions that are consistent with sound growth strategies, a growing economy, and commercial practices throughout the country.

In light of current federal procurement practices, we request that SBA consider amending its rule to allow for a company to recertify as small post-merger or acquisition if certain conditions are met. For example, if the combined size of buyer and seller is less than three times the size standard assigned to each contract, recertification as small may be permitted. In this way larger small businesses would have an opportunity to merge or be acquired to increase competitiveness without risking their current backlog. Agencies would be permitted to count the post-sale revenues toward small business goals. In this way, businesses could make business decisions based on market conditions without jeopardizing contract backlog, and agencies would continue to set aside larger contracts without the risk of not receiving small business credit for those set-asides.

- **SBA Should Not Require Mandatory Limitations on Subcontracting Compliance Disclosures**

SBA seeks comments on its proposed changes to limitations on subcontracting compliance. SBA proposes to empower COs with greater ability to monitor compliance by allowing them to request a demonstration of such compliance from small business prime contractors. SBA is leaving the form of the evidence provided by the prime contractors to the discretion of the CO and states that such documentation will not be required for all procurements. However, SBA is specifically seeking comments on whether such a demonstration should be a requirement for all procurements and, if so, what form the evidence of compliance should take and how often it should be provided to the CO.

Because COs are already working closely with small business prime contractors throughout contract performance, in addition to reviewing and approving their invoices, we believe that most of them will already have a good sense of whether the small business is complying with the limitations on subcontracting for the contract. If the CO believes there is reason for additional evidence to be submitted by the prime contractor, the CO should be able to request it at that time. Indeed, COs are already conferred with this authority and many routinely request such information. Requiring small business prime contractors to comply with mandatory limitations on subcontracting reporting at prescribed times provides yet another compliance burden to small businesses.

If SBA chooses to require mandatory compliance reporting, we suggest that the evidence provided to the CO take a similar form as the current certifications of compliance for mentor-protégé joint venture performance of work requirements, such as found at 13 C.F.R. §§ 125.8(d) and (h). These certifications could be provided to the CO based on the period of compliance for the applicable limitations on subcontracting. For most contracts, that will be at the completion of the base period of performance and each subsequent option period. If a CO requests that a contractor comply with the limitations on subcontracting in connection with a specific order issued under a multiple-award contract, the CO may request documentation of compliance for that order upon completion of the order.

If SBA decides to make limitations on subcontracting compliance reporting a mandatory requirement, it should provide the rule uniformly to all contracts subject to limitations on subcontracting. SBA has requested comments regarding whether the length or type of contract should be taken into consideration regarding the type of documentation provided to demonstrate limitations on subcontracting compliance. As stated above, it should be up to individual COs to decide whether such demonstration is required; the type of contract at issue and the length of the contract's period of performance should not matter. We note that SBA has asked for comments regarding whether documentation should be provided for contracts above the Simplified Acquisition Threshold ("SAT"). SBA should keep in mind that, while limitations on subcontracting do not apply to small business set-aside contracts under the SAT, they do apply to other socioeconomic set-aside procurements that fall under the SAT. It will be very confusing for small business prime contractors (and procuring agencies) to keep track of the various types of contracts impacted by a compliance reporting requirement—therefore, SBA should apply the requirement uniformly across all contracts requiring limitations on subcontracting if it decides to make such reporting mandatory.

- **Exclusions from the Limitations on Subcontracting Calculation Are Welcome**

We appreciate and firmly support SBA's decision to provide certain exclusions from the limitations on subcontracting calculation. We agree with SBA's decision to allow for the exclusion of other direct costs when they are not the principal purpose of the acquisition and SBCs do not provide the service. The examples included in the proposed regulation (airline travel, work performed by a transportation or disposal entity under a contract assigned the environmental remediation NAICS code (562910), cloud computing services, or mass media purchases) are good starts towards providing small business prime contractors relief in being able to comply with the limitations on subcontracting calculation.

We believe that there are additional industries beyond those listed as examples in the proposed rule where there are no small business subcontracting possibilities and the work being subcontracted is not the principal purpose of the acquisition. We request that SBA provide direction to small business prime contractors regarding the type of documentation or approval

process they should undertake if they wish to exclude subcontracting costs that are not explicitly referenced in SBA's proposed rule.

The proposed rule also states that a prime contractor may no longer count a similarly situated entity towards compliance with the limitations on subcontracting where the subcontractor ceases to qualify as small under the relevant socioeconomic status. We believe further clarity is required before this rule may be implemented because, unlike SBA's regulations applicable to prime contractors that have a certified small business or socioeconomic status, the regulations currently do not require subcontractors to provide recertification of size or status upon certain triggering events, such as merger or acquisition. As drafted, this regulation could be interpreted to require subcontractors to recertify size or status based on natural growth, which is not a requirement under the regulations applicable to prime contractors. We do not believe this is SBA's intent, so further clarification is required.

SBA has also proposed revisions to its rules regarding when an independent contractor may be counted towards compliance with the limitations on subcontracting. SBA proposes to distinguish between employee- and revenue-based size standards for when an independent contractor counts towards limitations on subcontracting compliance: for employee-based size standards, an independent contractor may be deemed an employee under the terms of SBA Size Policy Statement No. 1, and for revenue-based size standards, an independent contractor will not be considered an employee and will always be deemed a subcontractor.

We believe that SBA's proposed rule provides more confusion than clarity regarding whether an independent contractor "counts" for purposes of compliance with the limitations on subcontracting. If a totality of the circumstances analysis is the standard by which the determination of whether an independent contractor is considered an employee of the concern or not, as stated in 13 C.F.R. § 121.106(a), then this test should be applied consistently across all small businesses, not just those that fall under employee-based size standards. Otherwise, small businesses performing under multiple NAICS codes falling under both employee- and revenue-based size standards will not be able to consistently count an individual as an employee of the company.

- **SBA's Proposed Changes to the Ostensible Subcontractor Rule Are Unnecessary and Will Harm Small Businesses**

SBA is proposing to add language to allow it to make a determination concerning a small business program participant's overreliance on a non-similarly situated subcontractor as part of an eligibility or status protest determination. Such a relationship will be evaluated under the ostensible subcontractor test. If SBA finds that the subcontractor, regardless of size, is an ostensible subcontractor, SBA is effectively proposing a de facto rule that SBA will treat the arrangement as a joint venture that does not comply with the formal requirements necessary to receive or perform the socioeconomic program set-aside or sole source award.

This proposed rule should not be adopted in the final rule. SBA misses the point that, if an SDVOSB, HUBZone, 8(a), or WOSB is subcontracting to another small business (albeit a non-similarly situated entity), this still constitutes revenue to a small business. In this same rule, SBA has also proposed to allow an other-than-small prime contractor to include indirect costs in its subcontracting goals with the hope that this will increase the amount of funds the prime contractor will subcontract to SBCs. Indeed, SBA has explained that "[i]ncreasing the value and number of awards to small business concerns provides financial benefits to those firms, who may hire more staff and invest in more resources to support the increased demand." Despite SBA's recognition that the overall goal is to get more money into the hands of small businesses, this proposed ostensible subcontractor rule will do the exact opposite.

There are already sufficient mechanisms in place to prevent a large business from exercising undue control over a small business on a set-aside procurement. We fail to see the harm that SBA is trying to prevent when a small business plans to subcontract work to another small business, regardless of the subcontractor's socioeconomic status. Notably, the regulation already states that a contractor and its ostensible subcontractor will be treated as joint venturers and, therefore, affiliates for size determination purposes. 13 C.F.R. § 121.103(h)(4). Meaning, to the extent SBA finds an ostensible subcontractor rule violation, SBA will combine the size of the prime and subcontractor. If the combined size exceeds the applicable size standard, then the prime is deemed ineligible for that particular contract if it is other than small. The proposed rule seeks to go a step further and ignore the size standard applicable to the procurement. Rather than making this an issue of size, SBA has conflated the issues of size and status. Stated another way, SBA is improperly conflating eligibility for purposes of ownership and control (status) and eligibility for purposes of performing the contract (size).

The proposed rule creates a de facto status determination on a size issue. Even if there is an ostensible subcontractor rule violation, this does <u>not</u> mean that, for example, an SDVOSB does not comply with the ownership and control requirements applicable to SDVOSB procurements. The fact that SBA will automatically treat the arrangement as a joint venture that does not comply with the formal requirements necessary to receive and perform the award suggests that SBA is stating that, if an SDVOSB does not have the technical capability to perform the contract, it also cannot qualify as an SDVOSB in terms of status. There are already appropriate status protest procedures in place to determine the size and status of an SDVOSB, which include looking into reliance on a subcontractor. It is also confusing as to how this proposed rule would work practically, particularly in instances where the identity and/or size of a subcontractor is unknown. This will likely increase the number of status and size protests. Simply put, SBA is seeking to overregulate small businesses, and there is no real harm to small businesses in leaving things the way they are currently, as there are sufficient protections in place.

In addition to the current size and status protests, as well as the current affiliation regulations, SBA also has its certificate of competency ("COC") procedures. If there is a concern regarding a small business's ability to perform, such that it may be overly reliant on a non-similarly situated entity (but still a small business), SBA may already determine if the prospective awardee is responsible and able to perform the contract. Rather than automatically disqualifying the awardee, which the proposed rule seeks to do, SBA should initiate a COC if it is concerned with the awardee's ability to perform the contract.

- **SBA Reasonably Proposes to Remove the Kit Assembler Provision**

SBA's proposed change to remove the kit assembler part of the nonmanufacturer rule is a welcome change. As SBA noted, the kit assembler portion of the nonmanufacturer rule created confusion as to when a multiple-item procurement constituted a kit and when it constituted a procurement for separate items with separate manufacturers. SBA can eliminate the confusion by removing the kit assembler provision of the nonmanufacturer rule as proposed. With that change, any procurement for multiple items will fall under the existing rule for multiple item procurements, Section 121.406(e), regardless of whether the procurement requires assembly of a "kit."

- **The Proposed Clarification About when Size Is Determined Is Helpful**

SBA proposes to modify Section 121.404(a) to clarify that size is determined at the time of an initial offer including price and to clarify how that rule works in a context where initial offers do not include price. First, SBA's existing rule created some confusion about whether the initial offer or some later offer, such as a proposal revision, would set the date that size is determined. SBA's proposal to eliminate the reference to "other formal response to a solicitation" will remove that confusion and clarify that the date the proposal is first submitted is the critical date for size determination purposes.

Furthermore, SBA has proposed to clarify when size is determined in a procurement where an offeror does not submit an initial offer that includes price. This situation can arise on a multiple-award, IDIQ contract where price is not an evaluation factor. In that case, SBA's proposed rule would clarify that the date of the initial offer would be the date for the size determination, even though the proposal does not include price. We think this clarification is helpful, as small businesses need to know when their size is determined for all small business set-aside procurements, including IDIQ solicitations.

- **Clarification Where One Acceptable Offer Is Received on a Set-Aside**

We support SBA's proposal to revise 13 C.F.R. § 125.2 to provide that if a CO receives only one acceptable offer from a responsible SBC in response to any small or socioeconomic set-aside, the CO should make an award to that firm. Indeed, so long as the CO's expectation, based

on market research, is that he or she will obtain two or more fair-market price offers from capable SBCs, it should not matter how many offers are actually received or how many offers remain after evaluations are conducted, a competitive range is established, or offerors are eliminated in some other fashion. Lastly, we commend SBA for recognizing that this policy should apply to all set-asides, as it would be inefficient and detrimental to the government and offerors to prevent an award arbitrarily where a competition was conducted but only one offer was received.

- **The SBA Should Repeal the Presumption That Minority Shareholders Control a Business when No Majority Shareholder Exists**

In addition to our comments on the proposed regulations stated above, we submit that SBA should repeal the regulatory presumption that minority shareholders control a business when no majority shareholder exists because it has a strong negative impact upon small businesses that own small amounts of stock in other large concerns. SBA regulations currently provide that in situations where no person owns, controls, or has the power to control 50 percent or more of a concern's voting stock, SBA will presume that each person who owns, controls, or has the power to control holdings that are equal or approximately equal in size controls or has the power to control the concern. See 13 C.F.R. § 121.103(c)(2). While the regulation states that this "presumption may be rebutted by a showing that such control or power to control does not in fact exist," the presumption, as interpreted by OHA precedent, is nearly impossible to rebut in practice.

In Size Appeal of Mark Dunning Industries, Inc., SBA No. SIZ-5488 (2013), OHA held that the inability of a minority shareholder to prevent the board of directors from holding a meeting and deciding to take action was sufficient to rebut the presumption of control under the minority shareholder rule. However, OHA subsequently reversed its holding, stating that Mark Dunning was an outlier. See Size Appeal of Tenax Aerospace, LLC, SBA No. SIZ-5701 (2015); see also Government Contracting Resources, Inc., SBA No. SIZ-5706 (2016). In a recent decision, OHA found that a shareholder was presumed to control or have the power to control an entity which had 120 shareholders, each of which owed one share of stock, even though the shareholder did not control that entity through its single share. Size Appeal of Meltron Sales & Serv., Inc., SBA No. SIZ-5893 (Mar. 29, 2018). Indeed, as interpreted by OHA, in order to rebut the presumption, there must be clear evidence demonstrating control or the power to control by another party. "[I]n the absence of clear evidence demonstrating control or the power to control by another party, it is presumed that each minority shareholder has equal control over the subject concern, regardless of the size of the shareholder's interests." Meltron, supra.

We posit that OHA was correct in Mark Dunning, and its decision was consistent with the spirit of SBA regulations, which all require a showing of control or the power to control. Subsequent OHA precedent that upholds the presumption that a minority shareholder controls a

concern where there is no ability to prevent a quorum or block action contravenes SBA regulations and unreasonably ignores the concern's governing documents.

Moreover, it is unfair to small businesses that are only passive investors in a business concern owned by a large number of shareholders to be presumed to have control over that concern, as even a shareholder that is more than a passive investor still may not have actual control or power to control a concern. Furthermore, it is not uncommon for privately held companies to have multiple shareholders with equal ownership stakes. For instance, privately held companies, including small businesses, often have a small ownership interest in a captive insurance company, which is an insurance company owned and controlled by the insureds. Captive insurance companies often provide risk financing for their shareholders at a lower cost than can be found in the commercial insurance market. Applying a presumption of affiliation between small business and captive insurance companies of which they are shareholders works as an unfair competitive disadvantage to these small businesses. Such small businesses would typically be precluded from availing themselves of the benefits of captive insurance arrangements. In contrast, large business would not be prevented from having an interest in captive insurance companies where there is full and open competition. Finally, forcing a small business to place majority ownership of a company in which it has an ownership interest in the hands of a single shareholder, simply to avoid a presumption that everyone is in control, is a burden on the small business.

In the alternative, SBA should amend the minority shareholder rule in the size regulations to be consistent with the minority shareholder rule in its affiliation regulations for the Business Loan, Disaster Loan, and Surety Bond Guarantee Programs, as revised in 2016. In those regulations SBA recognized that, in a situation where all minority owners have holdings that are equal or approximately equal in size and there is no one individual who owns 50 percent or more, the holdings of the minority owners would be so diffused such that the president or board of directors would always be in control. See 80 Fed. Reg. 59667, 59669 (Oct. 2, 2015) (proposed rule). Accordingly, SBA revised Section 121.301(f)(1) to read as follows:

> For determining affiliation based on equity ownership, a concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50 percent of the concern's voting equity. If no individual, concern, or entity is found to control, SBA will deem the Board of Directors or President or Chief Executive Officer (CEO) (or other officers, managing members, or partners who control the management of the concern) to be in control of the concern. SBA will deem a minority shareholder to be in control, if that individual or entity has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

The same rationale applies equally to SBA's affiliation rules for Federal contracting programs. Thus, if a minority shareholder cannot actually control the concern, such as through the ability to prevent a quorum or block action, SBA should deem that the board of directors or highest officer of the concern controls.

For these reasons, Section 121.103(c)(2) should be repealed or amended to mirror Section 121.301(f)(1).

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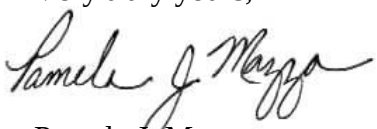
We appreciate the opportunity that SBA has given us to express the views of our small business clients and their teaming and joint venture partners about these proposed regulations. Please do not hesitate to contact the undersigned at (202) 857-1000 if you have any questions about these comments.

Very truly yours,



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