



# Everything You Need to Know about SBA's Manufacturer and Nonmanufacturer Rules

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July 17, 2019

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Jon Williams has over 15 years of experience advising contractors on a wide range of government contracting matters and Federal Acquisition Regulation compliance, including the federal procurement programs for small businesses (i.e., the 8(a), HUBZone, WOSB, and SDVOSB programs). He represents contractors in bid protests, size protests and appeals, and related administrative and court proceedings. Mr. Williams assists large and small contractors in navigating SBA audits and investigations, including subcontracting plan compliance reviews, IG investigations, and suspension and debarment proceedings. He regularly helps contractors to establish teaming, subcontract, joint venture, and mentor-protégé relationships.

Mr. Williams is a member of the HUBZone Contractors National Council Board of Directors and serves on their Government Affairs Committee. He is also a member of the Small and Emerging Contractors Advisory Forum (SECAF) and serves on their Legislation and Regulatory Committee.

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# Overview

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- SBA's rules for determining the manufacturer and nonmanufacturer for supply procurements
  - We will refer to the nonmanufacturer rule as the "NMR"
- Recent rulemakings and proposals
- Unique impact for the HUBZone price evaluation preference
- Utilizing mentor-protégé and JV relationships for supply procurements

# Why Size Matters

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- Small business status is the #1 eligibility requirement for all of the set-aside programs, and the #1 SBA protest issue
- The NAICS code assigned to a contract establishes how SBA measures size and the small business prime contractor's self-performance requirement for that contract
  - For set-aside contracts assigned a supply NAICS code, the prime contractor must either be the manufacturer of the product, or qualify as a nonmanufacturer

# What is a Manufacturer?

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- For size purposes, there can be only one manufacturer of the end item being acquired
- According to SBA's regulations, the manufacturer is the concern which:
  - With its own facilities
  - Performs the primary activities
  - In transforming inorganic or organic substances, including the assembly of parts and components, into the end item being acquired

# What is a Manufacturer?

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- “End item”
  - Must possess characteristics which, as a result of mechanical, chemical or human action, it did not possess before the original substances, parts or components were assembled or transformed
  - May be finished and ready for utilization or consumption, or it may be semi-finished as a raw material to be used in further manufacturing
- The manufacturer is not:
  - A firm that performs only minimal operations on the end item
  - A firm that adds substances, parts, or components to an existing end item to modify its performance if the identical modifications can be performed by and are available from the manufacturer



# How SBA evaluates the manufacturer

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- SBA evaluates the following factors in determining whether a firm is the manufacturer of an end item:
  - The proportion of the total value in the end item added by the efforts of the concern, excluding costs of overhead, testing, quality control, and profit;
  - The importance of the elements added by the concern to the function of the end item, regardless of their relative value; and
  - The concern's technical capabilities; plant, facilities and equipment; production or assembly line processes; packaging and boxing operations; labeling of products; and product warranties

# Installation of computer components

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- For firms that provide computer and other information technology equipment primarily consisting of component parts (such as motherboards, video cards, network cards, memory, power supplies, storage devices, and similar items), SBA examines value of the installed components compared to the total value of the end item
  - A firm that installs components totaling less than 50% of the value of the end item are generally not considered the manufacturer of the end item
  - For example, a firm that merely installs a video card that the manufacturer of a computer could have installed will not be considered the manufacturer of the computer

# SBA's Interpretations of the Manufacturer Rule

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- As long as a firm adds important functionality to the end item, the proportion of value added can be small compared to the total value
  - No one factor is more important than the other
  - SBA performs a case-by-case assessment of the functionality and value of the end item and the contributions made by the small business manufacturer
  - Example: Adding a safety switch to a saw
- Separately, compliance with the limitations on subcontracting is also required
  - The concern must perform 50% of the cost of manufacturing the supplies; this does not include the costs of materials

# SBA's Interpretations of the Manufacturer Rule

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- No absolute requirement to own the facilities, leasing is permitted
  - Can a JV be a manufacturer?
- Design, engineering, testing, and delivery contributions are not relevant to the determination

# What is a Nonmanufacturer?

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- A “nonmanufacturer” is essentially a reseller
- SBA’s NMR allows a small business “nonmanufacturer” to be the prime contractor on a set-aside supply contract as long as the small business nonmanufacturer:
  - Does not exceed 500 employees;
  - Is primarily engaged in the retail or wholesale trade and normally sells the type of item being supplied;
  - Takes ownership or possession of the item(s) with its personnel, equipment, or facilities in a manner consistent with industry practice; and
  - Supplies the product of a small business manufacturer made in the U.S., unless a waiver is granted

# Waivers of the NMR

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- SBA can issue two types of NMR waivers:
  - **Individual:** applies to a specific contract
  - **Class:** applies to an entire class of products
- An NMR waiver does not waive other requirements that may apply to supply contracts, such as the Buy American Act or the Trade Agreements Act

# Individual Waivers

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- Approved/issued by SBA
- Requested by CO
- Available when no small business manufacturer can reasonably be expected to offer a product meeting the specifications of a solicitation
- Applies to a specific contract only

# Process for Individual Waivers

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- CO submits a written waiver request to Director of SBA's Office of Government Contracting
- No particular format for request; SBA rules provide some suggestions
- Should be requested as early as possible in the acquisition planning so it can be issued in time to be included in the solicitation
- **Tip:** prepare a draft request for your COs so they can hit the "easy button"



# Class Waivers

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- Approved/issued by SBA
- Applies to an entire class of products
- SBA will issue a class waiver when no small business manufacturers are available in the Federal market for a class of products
  - “Available” means small businesses have been awarded a contract or submitted an offer to supply the class of products within the last 24 months
  - “Class of products” is a subdivision of a NAICS industry number
    - GSA Product/Service Codes (“PSC”) – List developed by GSA delineating all major product categories

# Process for Class Waivers

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- Any interested person, business, association, or Federal agency may submit a request to the Director of SBA's Office of Government Contracting, or SBA could initiate on its own
- No required format for the request, but must include:
  - Statement of class of products to be waived
  - Applicable NAICS code
  - Detailed information on the efforts to identify small business manufacturers or processors for the class
- **Tip:** Market research and definition of the product are key

# Current Class Waivers

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- Full list: <https://www.sba.gov/content/class-waivers/>
  - SBA has not updated the list in a while; check Federal Register to be sure
  - PM obtained last class waiver, for certain medical products, effective July 2, 2018

# Waivers for Multiple Item Procurements

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- For contracts seeking multiple items, a small business does not need to manufacture every item
  - If at least 50% of the estimated contract value is composed of items that are manufactured by small business concerns, then a waiver of the NMR is not required
  - If more than 50% of the estimated contract value is composed of items manufactured by large businesses, you need a waiver of the NMR for at least some of the items to ensure that at least 50% of the value of the products to be supplied are either made by small businesses or subject to an NMR waiver

# When the NMR Does Not Apply

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- The NMR only applies when the contract is assigned a supply NAICS code, or the IT Value Added Resellers (“ITVARs”) exception to NAICS code 541519 (see slide 22)
- When a contract is predominantly for services and is assigned a services NAICS code (other than the ITVAR exception to code 541519), the NMR does not apply to any supplies that may also be provided on the contract
  - Example: if an agency is primarily acquiring computer integration and maintenance services, and will also acquire some computer hardware, the NMR does not apply to the acquisition of the computer hardware; the small business must satisfy the 50% performance requirement for the computer integration and maintenance services

## Other exceptions to the NMR

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- Full and open procurements
- Subcontracts
- Small business set-aside procurements with an estimated value between the micro-purchase threshold and the simplified acquisition threshold

# ITVARs

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- Subject to the NMR when procurements are conducted under NAICS code 541519, Footnote 18
- History:
  - In 2002, SBA first created the “exception” to NAICS code 541519 for ITVARs, and at that time, the NMR did not apply
  - In 2014, SBA proposed to eliminate the exception and apply the NMR to ITVAR procurements because it was being “misused”
  - In 2016, SBA issued final rule that did not eliminate Footnote 18 but made clear that NMR does apply to these procurements
  - December 2018 SBA proposed rule clarifies that the size standard for ITVARs is 150 employees, not 500 employees

# ITVARs

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- Contracts classified under the ITVAR exception to NAICS code 541519 must consist of at least 15% and not more than 50% of value added services
  - “Significant value added services” include configuration consulting and design, systems integration, installation of multi-vendor computer equipment, customization of hardware or software, training, product technical support, maintenance, and end user support
- If the contract is less than 15% value added services, it must be classified under a supply NAICS code
- If the contract is greater than 50% value added services, it must be classified under the appropriate services NAICS code



# SBA's Interpretations of the NMR

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- A nonmanufacturer is not required to sell to the general public to be found primarily engaged in the retail or wholesale trade
  - For example, sales to the Federal Government fall under “retail or wholesale trade”
- “Normally sells the type of item”
  - Satisfied if the item is sold over a period of time, not merely occasionally
  - You do not need a track record of selling the exact item in question, but should be items of the same type; this requires a case-by-case assessment
  - Good to have a letter of authorization to act as a distributor

# SBA's Interpretations of the NMR

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- “Take ownership or possession of the item(s)”
  - Outgrowth of SBA concern that nonmanufacturers should add something of value to the contract beyond small business status
  - Either/or – nonmanufacturer does not have to take ownership and possession
  - Possession is physical, ownership is established by contract
  - Key language is “in a manner consistent with industry practice”
    - Drop shipping may be permitted
- Waiver must fit the item(s) at issue in the procurement
  - Solicitation must match the applicable waiver based on the NAICS code, PSC, and product descriptor

# NMR in Bid Protests

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- Does the proposal, on its face, demonstrate compliance?
- Market research for “Rule of Two” set-aside determinations
  - How should the agency factor the existence of an NMR waiver into its market research?
  - What about the possibility of an NMR waiver?
- Is an applicable NMR waiver included in the solicitation?

# Recent SBA Rulemakings on the NMR

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- Kit Assemblers
  - Under the current rule, if a small business makes the majority of the items in a kit, then no NMR waiver is required
  - SBA is proposing to remove the NMR kit assembler exception and instead it would apply the multiple item rule to kit assemblers
- SBA is confirming that ITVAR procurements are subject to the NMR and the size standard is 150 employees, not 500

# Recent FAR Rulemakings on the NMR

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- FAR Council has proposed a new FAR 19.103, Nonmanufacturer rule
- FAR Council has proposed to create a separate NMR solicitation provision, 52.219-XX
- As proposed, however, 52.219-XX does not align with SBA's NMR:
  - It does not mention that SBA can grant a waiver
  - It does not remove rules regarding "kit assemblers" which SBA has proposed removing
  - It does not include a provision requiring the contractor not to exceed 500 employees

# NMR for the HUBZone Price Evaluation Preference

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- The HUBZone Price Evaluation Preference, under FAR 52.219-4, only applies to full and open competitions
- Contrary to SBA's rules, FAR 52.219-4 provides that, for contracts valued over \$25,000, a HUBZone nonmanufacturer must furnish end items manufactured or produced by HUBZone manufacturers
- In a recent rulemaking, the FAR Council noted that the application of the NMR for acquisitions in which the HUBZone price evaluation preference is used is under review

# Utilizing Mentor-Protégé and JVs for Supply Procurements

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- SBA case law indicates a JV could be the manufacturer of a product and does not need to have its own facility; leasing the manufacturing facility would suffice
  - This opens the possibility of forming a mentor-protégé JV to qualify the JV as a small business manufacturer
  - What role could the small business protégé play in the manufacturing process?
    - The small business would need to be involved in more than administrative or ministerial functions of the JV
- Could a Mentor-Protégé JV qualify as a nonmanufacturer?
  - In theory, yes, but more complicated to determine how the JV would satisfy each element of the NMR

# Questions?

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