February 4, 2019

Via Regulatory Portal

Ms. Brenda Fernandez  
U.S. Small Business Administration  
Office of Policy, Planning and Liaison  
409 Third Street SW, 8th Floor  
Washington, DC 20416


Dear Ms. Fernandez,

On behalf of the American Bar Association (“ABA”) Section of Public Contract Law (“Section”), I am submitting comments on the proposed rule cited above. The Section consists of attorneys and associated professionals in private practice, industry, and government service.¹ The Section’s governing Council and substantive committees include members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The views expressed herein are presented on behalf of the Section. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the position of the ABA.²

¹ Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, and Scott Flesch, Marian Blank Horn, and Kristine Kassekert, members of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

² This letter is available in pdf format at https://www.americanbar.org/groups/public_contract_law/resources/prior_section_comments/ under the topic “Small Business and Socioeconomic Issues.”
I. **BRIEF SUMMARY OF PURPOSE FOR PROPOSED LIMITATIONS ON SUBCONTRACTING AMENDMENTS**

The U.S. Small Business Administration ("SBA") proposes to amend its regulations related to the limitations on subcontracting ("LOS") and small business subcontracting plans (the "Proposed Rule"). The Proposed Rule implements several provisions of the National Defense Authorization Acts ("NDAA") of 2016 and 2017 and the Recovery Improvements for Small Entities After Disaster Act of 2015 ("RISE Act"). It also implements other clarifying amendments.

The Proposed Rule would, among other things:

- Increase focus on prime contractors’ failures to make good faith attempts to comply with small business subcontracting plans;
- Clarify that contracting officers have the authority to request information in connection with a contractor’s compliance with applicable LOS clauses;
- Provide exclusions for purposes of compliance with LOS for certain contracts performed outside of the United States, environmental remediation contracts, and information technology service acquisitions that require substantial cloud computing;
- Require a prime contractor with a commercial subcontracting plan to include indirect costs in its subcontracting goals;
- Establish that failure to provide timely subcontracting reports may constitute a material breach of the contract;
- Clarify the requirements for size and status recertification;
- Limit the scope of Procurement Center Representative reviews of Department of Defense ("DoD") acquisitions performed outside of the United States and its territories;
- Authorize agencies to receive double credit for small business goaling achievements as announced in SBA’s scorecard for local area small business set asides in connection with a disaster; and
- Remove the kit assembler exception to the non-manufacturer rule.

SBA published the rule on December 4, 2018, at 83 Fed. Reg. 62516.

II. **COMMENTS**

A. **Good Faith Attempt to Comply with Small Business Subcontracting Plan**

The Section is pleased to see SBA’s increased focus on enforcing prime contractors’ obligations to make good-faith attempts to comply with small-business subcontracting plans. The Section is generally supportive of the Proposed Rule to support this increased focus. The Section,
however, is concerned about four of SBA’s proposed examples of activities “reflective of a failure to make good faith effort.” 83 Fed. Reg. at 62530.

First, the Section is concerned with the example of a material breach resulting from “[f]ailure to submit the acceptable individual or summary subcontracting reports in eSRS by the report due dates or as provided by other agency regulations within prescribed time frames.” Id. Even when a prime contractor makes every possible attempt to comply with its small-business subcontracting plan (i.e., exceeds reasonable efforts), the contractor might not meet the reporting deadlines. Under the Proposed Rule, the contractor could arguably find itself in material breach because it is unable—through no fault of its own—to submit specific reports in eSRS.

As DoD recently recognized in Class Deviation 2019-O0005, eSRS cannot accept the required reports for all contracts and orders:3

Currently, the Electronic Subcontracting Reporting (eSRS) does not support the submission of an Individual Subcontracting Report (ISR) for orders placed against BOAs and BPAs. Use of the deviation clause provided in Attachment 1, Alternate II of the FAR clause and Alternate I of the DFARS clause will ensure DoD is able to capture subcontracting data for these orders, by instructing contractors to submit the Standard Form 294, Subcontracting Report for Individual Contracts, to the contracting officer while eSRS is being modified to support the submission of ISRs.

If the eSRS reporting example in the Proposed Rule is strictly applied, other-than-small contractors will automatically be in material breach for every DoD BOA and BPA order. Further, if the eSRS system ever becomes unavailable, contractors could be in material breach. Finally, this example (unlike others) specifies the eSRS system and does not include any successor system. As a result, if the Government implements a successor system to eSRS, then all contractors would be in material breach. The Section therefore recommends that this example be amended to the following, with changes in bold:

Failure to submit the acceptable individual or summary subcontracting reports in eSRS, any successor system, or other method identified by the agency by the report due dates or as provided by other agency regulations within prescribed time frames, so long as delay is not caused by the government or other circumstances demonstrably outside the contractor’s control.

Second, the Section recommends clarifying the example of “[f]ailure to pay small business concern subcontractors in accordance with the terms of the contract with the prime.” 83 Fed. Reg. at 62530. There is a delicate balance to strike in providing strong incentives for other-than-small businesses to timely pay subcontractors, while ensuring good faith contract disputes with

subcontractors do not create material breaches. The Section recommends that SBA clarify that this example does not include a prime contractor’s withholding of payment based on a good-faith dispute over the subcontractor’s entitlement to payment under the terms of the subcontract.

Third, the Section recommends clarifying the example “[a]doption of company policies or documented procedures that have as their objectives the frustration of the objectives of the plan.” Id. If this example is intended to include policies or subcontract terms that limit subcontractors’ rights to contact the Government, beyond what is permitted under FAR 32.112, the Section recommends that the SBA state so specifically. If the example is intended to include other sorts of policies or documented procedures, the Section recommends that the SBA elaborate on the types of policies or documented procedures that would implicate this exception.

Fourth, the Section recommends that SBA remove the part of example (F) in bold below:

Failure to correct substantiated findings from federal subcontracting compliance reviews or participate in subcontracting plan management training offered by the government.

83 Fed. Reg. at 62530. Contractors meeting their subcontracting obligations should not be deemed to be in material breach merely for failing to participate in an offered subcontracting-plan management training.

B. Authority to Request LOS Compliance Information

The Section supports the proposed clarification in a new Section 125.6(e)(4) that contracting officers have the authority to request information in connection with a contractor’s compliance with applicable LOS clauses. Id. at 62519-20. The Section recommends clarifying that this authority applies after contract award.

C. Whether Small Business Must Demonstrate LOS Compliance at Fixed Periods

The Section applauds SBA for requesting comments on whether all small-business prime contractors should be required to demonstrate compliance with LOS to the contracting officer, and if so, how often:

SBA is requesting comment on whether all small business prime contractors performing set-aside or sole source contracts should be required to demonstrate compliance with LOS to the contracting officer, and if so, how often should this be required, such as annually or quarterly. What salient data would best provide assurance of compliance? Should demonstrating compliance depend on the length of the contract or the type of contract? Whether it is for commercial products and services? Whether the contract is fixed price? Whether the contract is above the SAT or the TINA
threshold? What other considerations should there be when applying the requirement for a contractor to document LOS compliance? We are requesting that industry provide comment on what information can be efficiently requested and provided.


The Section does not recommend that all small-business prime contractors be required to show compliance on a fixed-period basis. There are significant penalties for missing compliance with LOS, and the time and cost to both prime contractors and the Government of policing compliance on every contract would outweigh the marginal benefit gained.

But if SBA does establish an affirmative requirement to show compliance over certain periods, the Section recommends that requirement be consistent with the applicable period for compliance with LOS set forth in 13 C.F.R. § 125.6(e). Any time period for showing compliance to a contracting officer should not be shorter than Section 125.6(e) provides, generally the base period or subsequent option period(s).

Additionally, the Section recommends that any such fixed periodic compliance checks not apply to commercial suppliers. The Government encourages commercial companies to offer products to the Government; part of encouraging these companies involves limiting compliance requirements unique to the federal market. See, e.g., Federal Acquisition Streamlining Act of 1994, Pub.L. 103–355, Title VIII, FAR Part 12 and Department of Defense FAR Supplement (DFARS) Part 212 (which were enacted and implemented to expressly limit the application of noncommercial terms and conditions to commercial item and services procurements except where expressly authorized by statute or determined necessary by the applicable agency acquisition official). SBA should limit the compliance costs in this case by excluding commercial companies in full or, at a minimum, for contracts below the Truthful Cost or Pricing Data threshold. Further, if applied, the checks should be limited to a chart with the dollar value paid by the Government and the amount paid to each similarly situated and non-similarly-situated subcontractor. The contracting officer may then request supporting documentation if needed. The simple chart is efficient but also one that contractors should take seriously to avoid (inadvertently) providing inaccurate information to the Government and potentially triggering administrative or other remedies.

D. Recertification on Full and Open Contracts

Currently, SBA’s rules require recertification of size and status for all long-term (over 5 years) contracts. This includes indefinite delivery contracts under which orders will be placed at a future date and contracts that had not been set aside for small businesses, but were awarded to a small business. The Proposed Rule would clarify that a concern must recertify its status, not only on set-aside contracts, but also on full-and-open contracts. In addition, the Proposed Rule would add status recertification requirements for 8(a) participants and SDB concerns, which are already present in the SDVO, HUBZone, and WOSB regulations. The Section supports these proposed changes.
The Proposed Rule suggests that one result of these proposed changes may be that a prime contractor relying on similarly situated entities (e.g., a Service Disabled Veteran Owned Small Business prime with a Service Disabled Veteran Owned Small Business subcontractor) to meet the applicable performance requirements may not count the subcontractor towards its performance requirements if the subcontractor recertifies as an entity other than that which it had previously certified. Such a recertification could cause the prime contractor to fail to meet its LOS obligations, if the subcontractor in question had unique qualifications or the recertification happened so close in time to the end of the compliance period that the prime contractor could not replace the subcontractor in time to achieve its required workshare. Unlike other-than-small contractors, who could be excused from failing to meet their subcontracting-plan goals because they had made good faith efforts to comply (i.e., a subcontractor’s recertification is an unanticipated event), there is no such “good faith” exception to a small prime’s LOS obligation. The Section proposes that such a good faith exception be added to the LOS where the similarly situated entity recertifies to a non-qualifying size or status.

E. Proposed Amendments Relating to Certain LOS Exclusions

SBA proposes to add exclusions for certain costs so that they are not counted against LOS compliance. These costs relate to certain contracts performed outside of the United States, environmental-remediation contracts, and information-technology-service acquisitions that require substantial cloud computing.

The Section agrees with exceptions for contracts performed outside of the United States, environmental remediation contracts, where transportation and disposal of toxic waste cannot generally be performed by small-business concerns, and for exclusions for purchases of media services and cloud computing.

SBA is requesting industry comments on whether it should treat cloud computing as a supply, and therefore the non-manufacturer rule (“NMR”) would apply, which would allow SBA to issue individual or class waivers of the NMR for cloud computing. \textit{Id.} at 62520. SBA is also requesting comment on the definition of cloud computing. \textit{Id.} The Section believes that other regulatory bodies, such as the FAR Council, among others, are better situated to describe “cloud computing” and whether it is a service, supply, or combination of both. The Section respectfully suggests that the SBA should not weigh into this technology-driven and quickly-evolving area. Nonetheless, regardless of its characterization, the Section recommends that the SBA exclude cloud computing from the LOS.

The Section also recommends that travel costs be excluded from LOS calculations when obtaining travel services is not the contract’s principle purpose. The Section does not believe that excluding these costs will result in abuse. In this same vein, the Section recommends excluding the costs of mail and delivery services, utility services, telecommunications services, insurance costs and real estate leasing when these services are not the principle purpose of the contract. Further, the Section recommends excluding the cost of items the Government has determined by regulation are unavailable in the United States, as this significantly limits the chances that they can be supplied by a small business. This latter exclusion would include those items identified in FAR 25.104, Nonavailable Articles.
F. Indirect Costs in Commercial Subcontracting Plan Goals

The Section agrees that for commercial subcontracting-plan goals, contractors should be required to include indirect costs. 83 Fed. Reg. at 62518. This requirement will create consistency and easier compliance when comparing the summary subcontracting report to the commercial subcontracting plan. Because 95% of the 700 firms with commercial subcontracting plans in 2017 included indirect costs in their subcontracting goals (per SBA), id. at 62524, the change will also have minimal cost.

G. Independent Contractors

The Section agrees that if such an individual is considered an employee for size purposes, he/she should also be considered an employee for LOS purposes. Id. at 62518-19. The Section recommends that SBA reconsider the general treatment of independent contractors. In certain industries, it is common or even standard to engage certain workers as independent contractors instead of as employees. Thus, when independent contractors count as subcontractors, even when performing roles more akin to those of individual employees, complying with LOS becomes unduly difficult. In that case, those dollars paid to the independent contractors will be counted as being subcontracted. The rule was changed for overseas contracts for this same reason, and should be changed for domestic contracts as well.

H. Removal of Kit Assembler Exception

The Section agrees with the removal of the kit assembler exception. 83 Fed. Reg. at 62521. The Section agrees that the multiple-item rule in 13 C.F.R. § 121.406(e) sufficiently covers kit assemblers, such that removing the exception will reduce confusion by having only one non-manufacturer-rule procedure for purposes of multi-item procurements.

I. Changes to the Ostensible-Subcontractor Rule

The Section agrees with the proposed addition to the ostensible-subcontractor rule that will allow SBA to determine that a small-business-program participant is over reliant on a non-similarly situated subcontractor in an eligibility or status protest. Id. at 62520-21. Currently, the ostensible-subcontractor rule covers size, but not status, so an ostensible subcontractor would have to meet requirements for joint-venture ownership and control to still be eligible for a socioeconomic set-aside or sole source.

The Section appreciates SBA’s clarification that when two small businesses have an ostensible-subcontractor relationship, they will not be treated as affiliates with their size being aggregated. Instead, they will be treated as a joint venture. Id. As a result, if both entities are small under the NAICS code, and meet the joint-venture requirements, the relationship can be an eligible joint venture for the procurement, even if the entities’ receipts or employees in the aggregate would exceed the relevant size standard.


J. Discretion to Issue Socioeconomic Set-Asides on Small Business Multiple-Award Contracts

The Section asks that SBA reconsider affording discretion to an agency to set aside orders for particular small businesses when the underlying multiple-award contract was initially set aside for small business. *Id.* at 62518. Such an action could significantly decrease the opportunities available to all small businesses. This change would also be detrimental to small businesses if it takes effect after some of the businesses have made substantial investment in a multiple-award contract. The discretion should be allowed only when such socioeconomic set-asides were clearly contemplated at the time of solicitation of the multiple-award contract.

III. CONCLUSION

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

/s/

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Chair, Section of Public Contract Law

cc:
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