February 27, 2015

VIA REGULATORY PORTAL AND ELECTRONIC MAIL

Ms. Brenda Fernandez
Office of Policy, Planning and Liaison
U.S. Small Business Administration
409 3rd Street SW, 8th Floor
Washington, DC 20416


Dear Ms. Fernandez:

On behalf of the Section of Public Contract Law of the American Bar Association (the “Section”), I am submitting comments on the above-referenced Small Business Administration (“SBA”) Proposed Rule: Small Business Government Contracting and National Defense Authorization Act of 2013 Amendments (hereafter “Proposed Rule”). The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section’s governing Council and substantive committees have 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.1 The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.2

The National Defense Authorization Act of 2013 ("NDAA"), Pub. L. No. 112-339, 126 Stat. 1632 (Jan. 2013) contained a number of provisions impacting small businesses, including performance-of-work requirements applicable to small-business set-aside contracts and subcontracting-plan performance and evaluation requirements. The Section appreciates SBA’s efforts in implementing the NDAA provisions and other

1 Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, 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 under the topic “Small Business and Socioeconomic Issues” at: http://apps.americanbar.org/contract/federal/regscomm/home.html.
proposed changes to various small-business regulations, as well as requesting comments on certain issues relevant to small-business contracting opportunities. As set forth below, the Section encourages the SBA to provide additional clarification and guidance in the final rulemaking to ensure that the limitation-on-subcontracting requirements are administered fairly and consistently, and the other proposed changes will promote small-business contracting opportunities while balancing additional compliance burdens on large and small businesses alike.

COMMENTS

The Section’s comments address five areas intended to improve the final rule and address the SBA’s request for comments: (1) proposed changes to the performance-of-work requirements in 13 C.F.R. § 125.6; (2) the additional size-status-recertification requirement in 13 C.F.R. § 121.404(g); (3) proposed changes to the economic-dependence affiliation principle in 13 C.F.R. § 121.103(f); (4) new portions of 13 C.F.R. § 125.3 addressing subcontracting-plan notification requirements; and (5) suggested changes to procedures for North American Industry Classification System (“NAICS”) code appeals.

A. The Section Recommends that the SBA Consider Several Revisions to the Proposed Subcontracting Regulations.

Section 1651 of the NDAA mandated that the SBA implement a major conceptual shift with respect to the manner in which small businesses’ subcontracting is regulated in connection with small-business set-aside contracts. As the Proposed Rule states, the focus of the SBA’s proposed implementation has shifted “from the concept of a required percentage of work to be performed by a prime contractor to the concept of limiting a percentage of the award amount to be spent on subcontractors.” 79 Fed. Reg. at 77956. The NDAA further mandated that the “percentage of the award amount to be spent on subcontractors” be calculated (at least for supply and non-construction service contracts) based on the overall award amount. This differs from the current regulations, which require the performance-of-work requirements to be calculated based on either labor or manufacturing costs alone. Finally, the NDAA required that the limitations on subcontracting exclude those amounts subcontracted to similarly situated entities (as defined in the rule and discussed further below).

The Section believes that the proposed changes to 13 C.F.R. § 125.6(a) and (b) accurately implement the requirements of the NDAA set forth above.3 Furthermore, the Section agrees with the SBA’s decision to revise the regulations so that subcontracting limitations for construction contracts also must be calculated using a percentage of “the amount paid by the government to the prime,” even though this revision was not required by the NDAA. Although the NDAA required that this change be made only for supply and non-construction service contracts, the SBA’s choice to revise the

3 The Section notes that, while the Proposed Rule appears to account for the “similarly situated entity exception” in each of the various subsections of both 125.6(a) and 125.6(b), one or the other is likely sufficient.
regulations for all types of contracts promotes consistency. Moreover, this proposed revision would greatly simplify the calculation process for contractors and result in fewer inadvertent violations of this regulation. The Section views these revisions as improvements over the current regulations. Nonetheless, the Section notes several areas of the proposed rule that it believes should be clarified or revised.

1. Performance Requirements for Prime Contractors

Most importantly, the Proposed Rule does not appear to require prime contractors to perform any of the relevant contract work themselves. As stated, proposed 13 C.F.R. § 125.6 requires only that a certain percentage of work be performed by the prime and entities similarly-situated to the prime. It does not require any amount of self-performance by the prime. The Section suggests that proposed 125.6(a) be clarified to reflect whether or not the prime is required to self-perform any portion of work, or whether it may subcontract the entire amount up to the subcontracting limitation threshold. The rule itself states that the purpose of the NDAA is to ensure that a greater amount of work is performed by prime contractor small-business concerns. Clearly, both the implementation of a “similarly situated entity” exception and the elimination of any self-performance requirement promote the performance of work by other small businesses but not necessarily performance by the small-business prime contractor itself. The Section suggests that the SBA reconcile these inconsistencies in the final version of the rule.

The Section understands the fears expressed by the SBA with respect to the lower-tier, similarly situated subcontracting, and it agrees that there is potential for fraud and abuse. The Section also believes that the language included in the various subsections of 125.6(a) (“Any work that a similarly situated entity further subcontracts to an entity that is not similarly situated will count towards the . . . subcontract amount that cannot be exceeded”) will help to address this problem. That said, the Section has some concerns about whether prime contractors will be able to track lower-tier subcontracting and enforce these subsections’ requirements, and whether those requirements will create more confusion (and inadvertent violations) on the part of contractors. Presumably, the compliance requirements set forth in proposed 125.6(c) and (d) were intended to address those very issues. As written, they do not. The rule would require the contractor to certify, before performance, that it can comply with the new subcontracting-limitation requirements. Yet, there appears to be neither any mechanism for investigation or enforcement during performance nor any sort of post-completion verification process. In effect, the proposed rule would gauge compliance with regulation on pre-performance conjecture, rather than actual satisfaction of the subcontracting-limitation requirements. Thus, while the Section commends the SBA on its efforts to ensure compliance, the Section recommends that the SBA reconsider the timing of the required compliance.

2. Notification Requirements

The Section is also concerned that the function of § 125.6(e) is unclear. The proposed section requires a prime contractor to notify the contracting officer in writing
of a change to a subcontractor’s award amount after award of the prime contract that would increase the percentage of the prime contractor’s award amount spent on subcontractors that are not similarly-situated entities such that the percentage no longer complies with the requirements of § 125.6(a). The Proposed Rule’s preamble, however, suggests that a different contract action triggers the notification requirements:

Proposed § 125.6(e) would address the process for continued compliance with the limitations on subcontracting when the award amount of a small business set-aside or small business program set-aside contract is modified. This process would require that the prime contractor provide the contracting officer with documentation to demonstrate how it will continue to satisfy the applicable limitations on subcontracting. The SBA seeks comments on this process and specifically requests suggestions for how procuring agencies can more effectively monitor compliance with the limitations on subcontracting when the award amount has been modified after award.

79 Fed. Reg. at 77957 (emphasis added).

This comment seems to indicate that the triggering event is the modification of the prime contract, not a subcontract, and thus contradicts the plain language of the proposed section. The Section proposes that the SBA clarify that § 125.6(e) is intended to require a prime contractor to notify the contracting officer if it modifies a subcontractor’s award under certain circumstances.

3. Exemption Threshold

In addition, the SBA proposes to add new paragraph 125.6(j), which would exempt small-business set-aside contracts valued between $3,000 and $150,000 from the limitation-on-subcontracting requirements. The requirements would continue to apply to all 8(a), HUBZone, SDVO, and WOSB/EDWOSB set-aside contract awards regardless of value, including contracts with values between $3,000 and $150,000. Nonetheless, the language of the proposed paragraph would not establish those dollar figures but rather exempt contracts “with a value greater than the micro-purchase threshold but not greater than the simplified acquisition threshold.”

The proposed change seems to rest on balancing the enforcement costs and administrative burdens on agencies and contractors with the potential magnitude of any harm. The Section notes, however, that the Federal Acquisition Regulation (“FAR”) makes it the policy of the federal government to set-aside all contracts under the Simplified Acquisition Threshold (“SAT”) for small business. In the aggregate, acquisitions under the SAT represent a substantial share of government contract spending.

The Section also notes that, in its recently proposed budget, the White House proposed that Congress raise the simplified acquisition threshold from $150,000 to $500,000. If this proposal is accepted, the exemption proposed as paragraph 125.6(j)
would apply to significantly more contracts than anticipated under the current $150,000 simplified acquisition threshold and involve a far greater share of procurement dollars.

As the SBA states in the Proposed Rule:

The SBA’s proposal to not apply the subcontracting limitations to non-socioeconomically disadvantaged small business set-aside contracts between $3,000 and $150,000 does not, however, reduce the importance of these limitations on small business set aside contracts over $150,000 and all contracts that are set aside for socioeconomically disadvantaged small businesses. It is critical that firms that obtain set aside and preferential contracts comply with applicable subcontracting limitations. The Government’s policy of promoting contracting opportunities for small and socioeconomically disadvantaged businesses is seriously undermined when firms pass on work in excess of applicable limitations to firms that are other than small or that are not disadvantaged.

79 Fed. Reg. at 77,957.

Accordingly, the SBA and the interests of small businesses may favor removing this proposed exception, particularly given that the universe of contracts under the SAT may expand substantially if the SAT is raised as requested in the President’s budget. In any case, the Section proposes that, at a minimum, the SBA await Congress’s decision on the President’s proposal to raise the SAT before adding the proposed paragraph 125.6(j). The public should have the opportunity to comment on the proposed exemption with the understanding that it may affect contracts up to $500,000 in value if that is likely to be the case in the near future.

4. Award Types Covered

Additionally, given that the SBA has distinguished between contracts and task orders in other aspects of its regulations, the Section reads the language of the proposed new paragraph and the supplementary information as applying only to stand-alone contracts, not to task orders under indefinite-delivery, indefinite-quantity contracts or other contract vehicles such as the Federal Supply Schedule program. The applicability of the exemption to task orders would be a dramatic expansion of its reach. Accordingly, the Section recommends that the SBA clarify or confirm in the final rule that the exemption would, in fact, apply only to stand-alone contracts.

B. The Section Recommends that the SBA Clarify the Timing Requirements for the Post-Offer, Pre-Award Recertification Requirement

The Section believes that the SBA should provide timing guidelines for entities required to recertify their small-business status due to an acquisition or merger that occurs after the entity has submitted an offer but before an award has been made. Under the current rules, post-award recertification due to an acquisition or merger is required within 30 days of an approved contract novation or, when no contract novation is required, within 30 days of the transaction’s becoming final.
Nevertheless, the Proposed Rule does not contain a 30-day requirement for pre-award recertification and provides only that the offeror must recertify “prior to award.” This language is vague and could be read to imply that a firm is required to recertify immediately upon acquisition or merger, up to the moment before an award is made. Under this premise, if a firm triggers the recertification requirement on the same day that an award is made, but fails to inform the contracting officer prior to award, that firm could be liable for false certifications regarding its size. To prevent any suggestion that this is what the SBA intends, the Section recommends that a 30-day requirement be added for the pre-award period instead of the requirement to recertify “prior to award,” so as to be consistent with the existing recertification timing rule in 13 C.F.R. § 121.404.

C. The Section Seeks Clarification on the Impact of Proposed Changes to 13 C.F.R. § 121.103 on Related Small Business Regulations.

The Section believes that the SBA should provide guidance on the effect of the proposed change to 13 C.F.R. § 121.103, which presumes identity of interest and economic dependence when one entity derives 70 percent or more of its receipts from another business concern in the previously completed fiscal year. Although the proposed regulation states that there is no current fixed percentage that the SBA applies when evaluating economic dependence, the SBA’s Office of Hearings and Appeals (“OHA”) has previously established a general rule “that where one concern depends upon another for 70% or more of its revenue, that concern is economically dependent upon the other,” Size Appeal of Rockwell Med., Inc., SBA No. SIZ-5559 (2014), and economic dependence can be found with a fixed percentage as low as 40 percent if other factors are considered, such as engaging in a formal long-term joint venture. Id. (citing Size Appeal of David Boland, Inc., SBA No. SIZ-4965 (2008)). The Section seeks clarification as to whether the SBA intended to overturn OHA’s case law, which allows a finding of economic dependence below the 70 percent threshold if other factors are present.

The Section also seeks clarification on the effect of the proposed change to 13 C.F.R. § 124.106, which provides that for the 8(a) Business Development Program, control by a non-disadvantaged entity will be found where “[b]usiness relationships exist with non-disadvantaged individuals or entities which cause such dependence that the applicant or Participant cannot exercise independent business judgment without great economic risk.” OHA has determined that this prohibited dependence can be economic dependence and applied a “substantially all revenues” test to determine economic dependence. See Matter of Harris Grant, LLC, SBA No. BDPE-478 (2013). The Section seeks clarification as to whether the 70 percent threshold is intended to be used as the test for economic dependence for 13 C.F.R. § 124.106 as well as for 13 C.F.R. § 121.103.
D. The Section Recommends that the SBA Provide Additional Guidance on Subcontracting Plan Notification Requirement.

The Section is concerned that the requirements in the Proposed Rule regarding a prime contractors’ subcontracting plans does not provide sufficient information for prime contractors to comply with the NDAA requirements. The Proposed Rule requires a prime contractor to provide written notice to any small-business subcontractor identified by name by the prime contractor in a proposal, offer, or bid. There is no guidance, however, on the purpose, substance, or form of the required notification. For instance, must the prime contractor convey the work or proposed work share to be performed by the proposed small-business subcontractor? Similarly, would a teaming agreement between the parties suffice to meet the notification requirement? The Section recommends that the SBA clarify the Proposed Rule as to how prime contractors can meet the notification requirements.

In addition, the Proposed Rule does not explain how the Government will confirm that a prime contractor has met the requirement to notify proposed small-business subcontractors. Relying upon the proposed small-business subcontractors to police the prime contractors on this requirement is an unworkable solution because only small-business subcontractors that receive notice will be in a position to know that the prime contractor was supposed to provide notice. Subcontractors generally are not provided with access to the prime contractor’s proposal, offer, or bid. Thus, if the prime contractor fails to notify the small-business subcontractor of its inclusion in the proposal, offer, or bid, the small business will generally have no reason to know that the notification was even required. The Section recommends that the SBA include additional instructions in the Proposed Rule for the prime contractors to report their compliance with the notification requirement.

The Proposed Rule also requires that any person with a reasonable basis to conclude a prime contractor or subcontractor has made a false statement to the Government regarding a subcontracting plan must report the matter to the SBA Office of Inspector General (“OIG”). Given the significant penalties associated with failure to comply with the requirements of a subcontracting plan (e.g., liquidated damages, material breach of contract, past performance consideration), the Section is concerned that there is no provision in the Proposed Rule providing notice of the charge to the reported contractor, nor is there provision for how the contractor will be afforded an opportunity to address the matter. The Section recommends that the SBA consider requiring the SBA OIG to provide the reported contractor a copy of any such notification and an opportunity for the reported contractor to respond before the OIG formally requests additional information.

E. The Section Recommends that the SBA Consider Using Size Protest Procedures as a Model for NAICS Code Appeals.

The SBA is also seeking comments regarding the appropriate timeline for the filing of a NAICS code appeal. The Section recommends that the SBA adopt a timeline for NAICS code appeals similar to the one in place for size protests. Currently, a size
protest must be filed by the fifth business day after bid opening or notification of award. The five-day requirement allows the SBA to address the issue in a relatively short timeframe, while providing the protester a realistic opportunity to file its challenge. The Section believes that a five-day requirement would likewise work for NAICS appeals, as it would provide offerors a realistic opportunity to protest the selected NAICS code while providing sufficient time for the SBA to notify offerors of the protest and to make a timely decision.

The SBA is also seeking comments on whether a NAICS code appeal should trigger a stay of contract award or delay of the offer or bid response date. The Section believes that a stay of award or delay of the offer or bid response date is a key element of the NAICS code appeal process. A challenge to a NAICS code almost certainly involves a change to the size standard by which contractors would certify their status as a small business for the procurement. A change to the NAICS code, and the accompanying size standard, could result in otherwise ineligible contractors suddenly meeting the size standard as a small business, and vice versa. Thus, the Section recommends the SBA create a mechanism so that the offer or bid response date is tolled pending the resolution of the NAICS code appeal.

As with the timeline issue, the Section believes that a good guide for the NAICS code appeal process is the process established for size protests. The current size protest regulations provide for a stay of contract performance while the SBA is making its size determination. Generally, the contracting officer cannot make an award after a size protest has been filed until either the SBA has made a size determination or 15 business days have passed, whichever is later. This timeline allows for a quick resolution of the protest and minimal disruption to the procurement process. The Section believes a similar procedure would be advantageous for NAICS code appeals. The SBA could set a minimum period for the tolling of the bid or response date, not only to allow for a reasonable amount of time to resolve the NAICS code appeal but also to allow the agency to move forward if the appeal process is significantly delayed.

CONCLUSION

The Section applauds the SBA’s use of the notice-and-comment process and its efforts to implement the sections of the NDAA pertaining to small businesses. These comments are meant to suggest improvements to the SBA’s implementation effort and to encourage the SBA to continue seeking assistance from other agencies and the public while refining its regulations. The Section respectfully requests that the SBA consider the issues identified in these comments in developing any final rule to implement the Act’s limitation-on-subcontracting and subcontracting-plan requirements, as well as other changes to affiliation, recertification and NAICS code appeals. The Section is available and willing to provide any additional information and assistance as the SBA may require.
Sincerely,

Stuart B. Nibley
Chair, Section Public Contract Law

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