November 15, 2016

Overview of New Regulatory Changes & SBA Trends

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Part One: DC Update

- Native Contracting Landscape
- Legislative Update
- Rothe: Constitutional Challenge of the 8(a) Program
- DOT DBE Program: New Guidance Issued
- New Law: Defense of Trade Secrets Act (DTSA)

Native Contracting Landscape

New SBA District Director for Alaska, Nancy Porzio

- History at SBA
  - Joined the SBA in 1987 in Anchorage, Alaska
  - Seattle District Office Director
- Compliance
  - Compliance function will be migrating back to Alaska office
- Future for Alaska District?
  - Could be a Center for Excellence in ANC 8(a) matters
  - SBA could hire attorney in Alaska to do all ANC work

Native Contracting Landscape

- **Much less 8(a) sole-source contract dollars obligated on contracts *below $20 mil***
  - 36% reduction in all 8(a) sole-source contract dollars from FY10 to FY14
    - However, 8(a) sole-source remains largest (37%) competition category for ANCs
- **Not all bad:** Significant ANC *growth* in other competitive areas
  - ~100% increase in small business set-asides from FY10-14
  - 15.3% increase in 8(a) competed from FY10-14

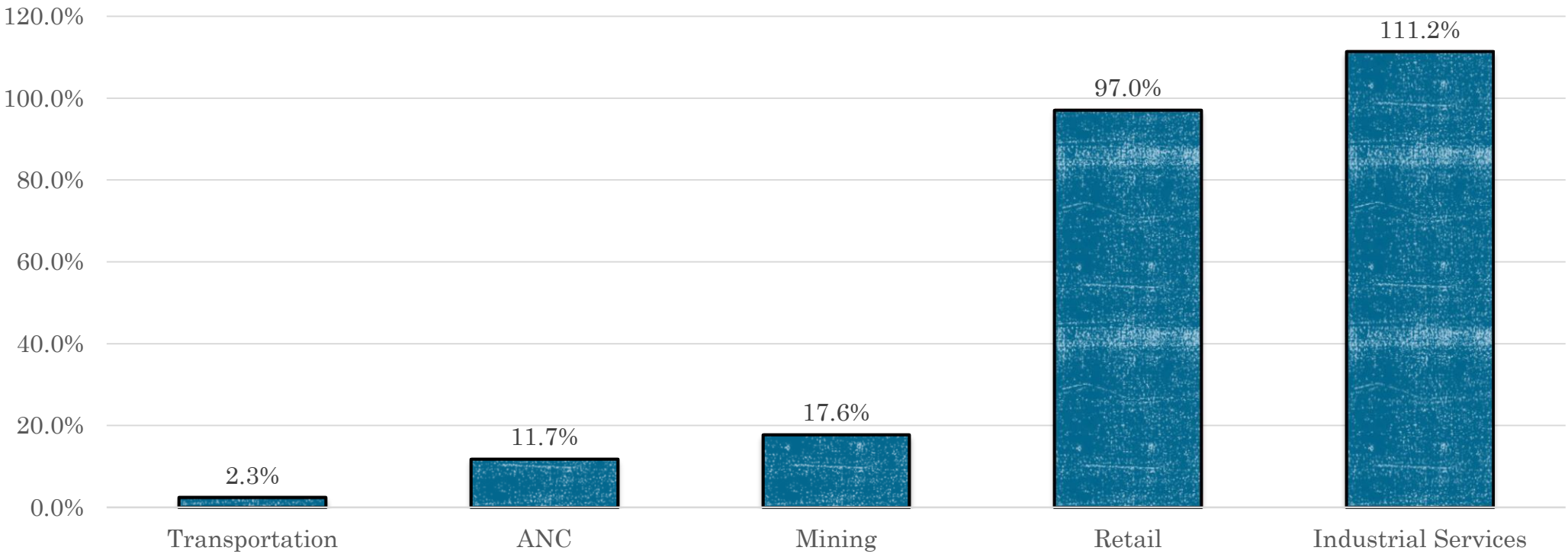
Overall: ANCs contracting dollars obligated is at all-time high

- Total ANC Contract Obligations
  - FY14: $7.3 billion in ANC contracting
  - FY13: $5.8 billion
  - FY12: ~$6.5 billion

October 2015 Bloomberg Government Report offers additional data

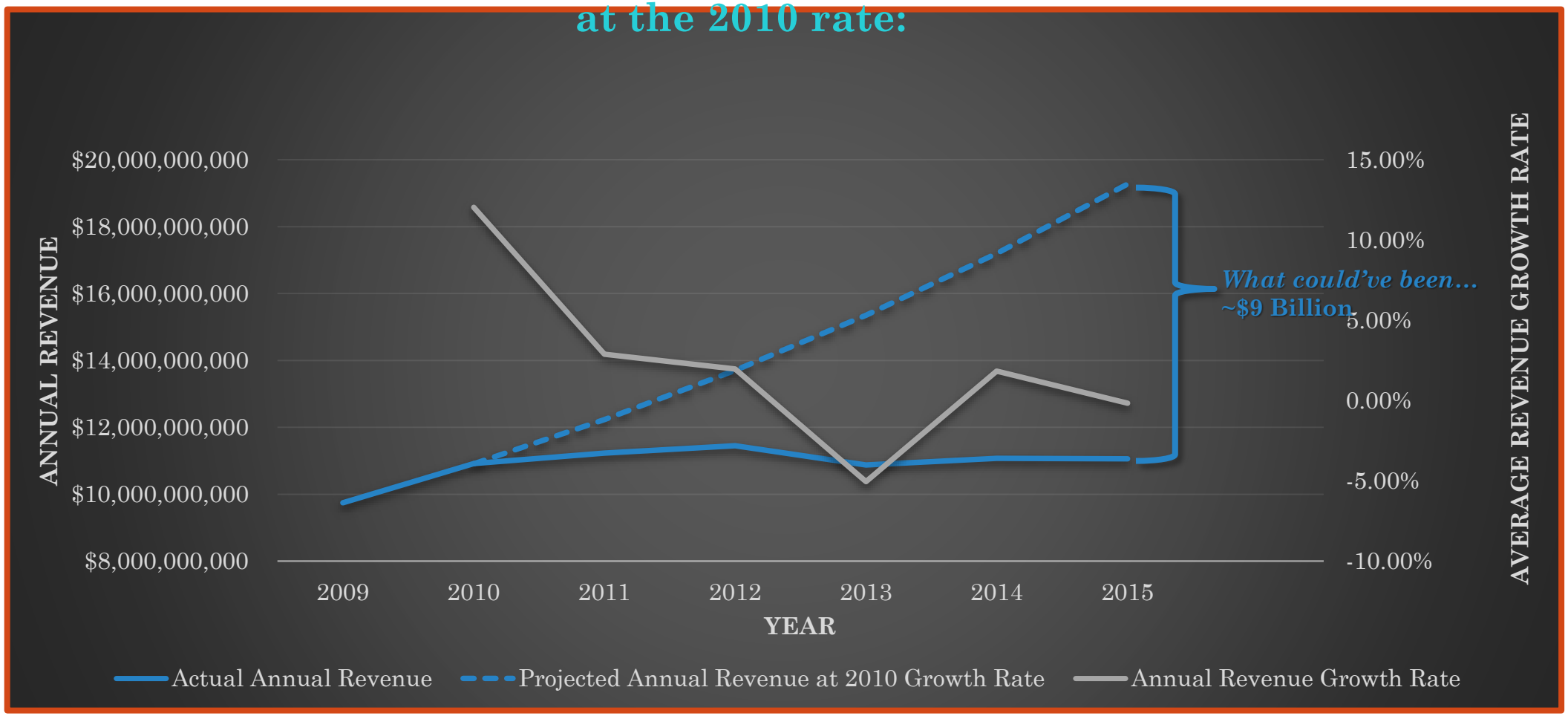
ANC Stagnation Compared with Other Alaska Industries

Percent increase of annual revenue of *Alaska Business Monthly's Top 49ers* by industry from 2009 to 2015



Top 49er ANC Revenue Plateau

ANCs have had their revenue grow at much slower rate (or even decrease) since 2011. Compare actual revenue to projected revenue at the 2010 rate:



Native Contracting

Legislative Update

NDAA & Appropriations

FY17 National Defense Authorization Act

- **Passed** both House and Senate
- In Conference Committee to iron out differences
  - **Big sticking point:** Overseas Contingency Operations ("OCO") funding; Sage Grouse protections
  - **Negotiation breakthrough:** negotiators decided to split the difference and provide $9 billion in additional funding through the OCO
  - **House Armed Services Chairman:** Negotiations "are in a pretty good place"
- **Timetable:**
  - Final passage projected for first week or two of lame duck (starts November 14)
  - Signed into law each year for over a half-century
- **Veto Threats**
  - President Obama has issued a veto threat over numerous provision in the House bill

FY17 National Defense Authorization Act

Proposed Changes in Either House or Senate Bills:

- **Reorganization of the Department of Defense acquisitions structure**
- **Section 811 changes**
- **Expansion of the automatic Small business set aside range**
  - The House proposes a provision pegging small business set-aside threshold to above whatever the micro-purchase threshold is pegged at and below the simplified acquisitions threshold peg.
  - Obama administration is proposing to increase the simplified acquisitions threshold to $500,000, which would increase small business set aside to ~$3,000-$500,000
- **Mentor-protégé program modifications**
  - Migrates MP duties from DoD to SBA
  - Requires MP agreements to ensure protégés are aware of no-cost small business regulation compliance assistance programs run by the SBA
- **Exemptions for the Fair Play And Safe Workplaces Executive Order**
  - House: exempts all DOD contracts from Fair Play and Safe Workplaces EO
  - Senate: applies only to contractors who have been suspended or debarred as a result of labor law violations, rather than those who have had any violations whatsoever.
- **GAO bid protest changes**
  - Contractors who file certain protests will be responsible for the costs incurred.
    - These protests include those which have all of their elements denied by the GAO and filed by parties with revenues greater than $100 million the previous year.
  - Incumbent contractors who file protests will have costs withheld from them during any bridge or temporary contract extensions as a result of a delay of such a protest.
  - Barred from protesting task and delivery orders if the DoD establishes a task and delivery

Continuing resolution & Mini-buses

- **Continuing Resolution**
  - Government passed a Continuing Resolution ("CR") to keep the government funded through December 9
  - The CR will extend funding long enough to give Congress three full session weeks to pass full-year FY17 appropriations funding.
- **Appropriations**
  - House has passed all 12 bills; Senate passed only 1 (Veterans in CR)
    - Senate Democratic filibustered all twelve
    - Congress won't likely have the time to pass the twelve appropriations bills, but they may have enough time to avoid doing an omnibus bill.
  - **Mini-Buses:** House and Senate Republicans are hoping to split the appropriations measures into more manageable "mini-bus" appropriations measures, grouping two to four of the individual bills together.
    - This strategy might allow Congress to include more policy riders while also diffusing the chances of a government-wide shutdown.
    - Postponing full-year appropriations passage until after the election could cause shifts in partisan strategy depending on the outcome of the election and the makeup of the 115th Congress.

Rothe: Constitutional Challenge of the 8(a) Program

Rothe Case: D.C. Circuit Upholds Constitutionality of the 8(a) Program

- *Rothe Development, Inc. v. Department of Defense*
  - Latest in a series of cases challenging the constitutionality of the 8(a) Program. Some past challenges have resulted in significant changes to federal small business development programs.
- **2015 D.C. District Court decision:** Section 8(a) contains a racial classification, but it is constitutional on its face because it is "narrowly tailored" to a "compelling government interest" in eliminating the roots of racial discrimination in federal contracting – passes high bar of "strict scrutiny" analysis.
- **Key Issue on Appeal:** Whether Section 8(a) of the Small Business Act is unconstitutional because it contains an impermissible racial classification and provides race-based preferences in federal contracting.

Rothe

Rothe Case: D.C. Circuit Upholds Constitutionality of the 8(a) Program

- **Holding:** Section 8(a) of the Small Business Act is facially constitutional, but for different reasons than those found by the district court.
  - Found that Section 8(a) itself does not contain a racial classification, and there are no racial or ethnic presumptions built into the statute itself; rather, the statute focuses on socially and economically disadvantaged small businesses.
  - Therefore, the statute only needs to pass "rational basis" analysis, bearing a "rational relation" to a "legitimate end."
    - This is a lower bar of constitutional analysis than applied by the district court – Section 8(a) easily meets this test.
  - Critically, the Circuit Court focused on the fact that Rothe attacked the underlying statute and not the SBA regulations that actually implement the 8(a) Program.
    - **Important distinction –** the Circuit Court judges indicated **that a challenge to the SBA regulations might have had a different outcome,** or at least a different level of constitutional scrutiny applied to the relevant review.
- **Supreme Court?**
  - **Not yet**: Rothe petitioned for the *entire* D.C. Circuit Court of Appeals to review their case; the last step before the Supreme Court
  - Rothe argues the three judge panel mistakenly held the statute had no racial classifications because the statute defines "disadvantaged individuals" as members of specific racial groups, which amounts to an impermissible racial classification

Why Rothe Really Matters

- Ultimate case outcome has the potential for broad-reaching implications for small disadvantaged businesses participating in this key sector of federal government contracting
- While the D.C. Circuit decision is positive for small businesses, this case may not be over yet
  - Rothe has until December 8 to file an appeal with the U.S. Supreme Court
    - Would be the first SCOTUS affirmative action case related to federal government contracting since 1995
    - Given the discussion of regulation v. statute, Rothe may be very encouraged to file a new lawsuit challenging the regulations (not just the statute) as facially unconstitutional. Such a lawsuit would proceed independently of any SCOTUS appeal.
- What happens if the 8(a) Program regulations are struck down?
  - This would effectively eliminate the presumption of disadvantage for certain groups, leaving the 8(a) Program to operate much like the women-owned small businesses applicants.
  - Individual applicants applying for the 8(a) Program would have to cite their personal stories of disadvantage and prejudice, and the SBA would determine eligibility based on each person's personal experience.
  - While not precluded now under the standards, that avenue could become the primary way of establishing social and economic disadvantage for all individuals.
  - Note: the participation of Alaska Native Corporations and tribal companies in the 8(a) Program are subject to different legal standards compared to other disadvantaged groups, due to Congress's expansive ability to legislate matters relevant to the U.S. relationship with Native Americans. Therefore, if the 8(a) Program regulations are struck down, it is likely that contracting preferences for these groups could be preserved, but a new program may have to be created.

U.S. Department of Transportation Disadvantaged Business Enterprise Program

New DOT Guidance Issued to Clarify Certified ANC Qualifications for the DOT DBE Program

What is the DOT DBE?

- Program authorized by Congress in 1982
- U.S. Department of Transportation's ("DOT") Disadvantaged Business Enterprise ("DBE") Program requires state transportation departments to pay 10% of their federal transportation funds to DBEs
- **State DBE Programs:** DoT requires states to have DOT-approved DBE programs in order to receive federal transpiration funds
- **No Set Asides:** agencies are not allowed to use set asides or quotas to meet their DBE goals
  - Eligibility is based on social and economic disadvantage
- **Practice Tip: Great opportunity for contracts**

Qualifying as a DBE

- Generally, to qualify to participate in the DOT's DBE program, a firm must qualify under four types of eligibility requirements:
  - **Size**
    - Firm meet SBA Size Standards for the type of work the firm seeks under DBE, including its primary NAICS code; and
    - Firm must meet DOT's own maximum size limit ($ 23.98m)
  - **Socially & Economically Disadvantaged**
    - The owners of the firm must be socially and economically disadvantaged
  - **Majority Ownership/Corporate Control**
    - The disadvantaged group members must own a majority of the firm
  - **Actual Control**
    - The disadvantaged owners/individuals must actually be in control of the firm
- Certified ANCs are exempt from these general qualifications.
  - DOT: "…an entity meeting criteria to be an ANC-owned firm must be certified as a DBE, even if it does not meet size, ownership, and control criteria otherwise application to DBEs. For example, an ANC-related entity could exceed SBA small business size standards or have its daily business operations controlled by a nondisadvantaged individual and still be certified if it met the section 702 criteria." 68 Fed. Reg. 35542.

Categories of Eligibility

- Eligibility requirements vary by type of applicant
- **"Certified" ANCs: "The Easy Way"**
  - SDB/8(a) Certified ANCs
  - Must provide proof of ANCSA-sanctioned ANC and SDB/8(a) status
  - Least strenuous qualifications
- **Non-Certified ANCs and Other Entity-Owned Applicants: "The Hard Way"**
  - Indian Tribes, NHOs, and Non-SDB/8(a)-Certified ANCs
  - Must qualify on size (49 CFR 26.65) and control (49 CFR 26.71), but exempt from other generally applicable qualifications.
  - Moderate number of qualifications, but difficult for ANCs to qualify in practicality
- **General Eligibility Requirements**
  - Applies generally to individually-owned applicants
  - Must qualify on size, socially and economically disadvantaged status, majority ownership/control, and actual control.
  - Most robust eligibility requirements

The Easy Way or the Hard Way

- **Easy Way:** ANC-owned businesses that are certified as 8(a) or SDB have an **easier process** to qualify as DBEs. The new DOT Guidance is pertinent to this category of DBE applicants.
- **Hard Way:** ANC-owned businesses that are not certified, must qualify along with Indian Tribes and NHOs
  - Much more involved process
- **Inconsistent Implementation for ANCs**
  - ANCs experienced inconsistent interpretation and implementation of federal regulations, long delays in application processes, and push-back from state implementers
  - BBNC and others repeatedly appealed to DOT to issue new guidance to clarify areas of confusion and inconsistent implementation, especially as DOT regulations relate to other laws (ANCSA, SBA regulations, etc.)
- **DOT issues new policy guidance**
  - In response ANC requests and pressure from Capitol Hill, DOT released September 2016 guidance document that clarifies what is required for certified ANCs to qualify for DBE program

DOT Guidance for Certified ANCs: Self-Certification is Acceptable

- DOT Guidance is provided in a Q&A format
- DOT Question 1: "*Must Unified Certification Program (UCP) recipients that are certifying agencies accept for DBE certification firms owned by an ANC that have **self-certified** as a small disadvantaged business (SDB)?*"
  - DOT Answer Part 1: *Yes, self-certification by ANC owned firms that are reviewed and accepted by the SBA "complies fully with and meets the statutory mandate" of the US DOT DBE Program for ANCs.*

DOT Guidance for Certified ANCs: What are the qualification criteria for Certified ANCs?

- ***DOT Answer Part 2 (Guidance Text):***
  - *"Pursuant to 43 U.S.C. 1626€(4)(C), DOT regulations require that an ANC meeting all of the following criteria **must** be certified as a DBE:*
    - *(i) The Settlement Common Stock of the underlying ANC and other stock of the ANC held by holders of the Settlement Common Stock and by Natives and descendants of Natives represent a majority of both the total equity of the ANC and the total voting power of the corporation for purposes of electing directors;*
    - *(ii) The shares of stock or other units of common ownership interest in the subsidiary, joint venture, or partnership entity held by the ANC and by holders of its Settlement Common Stock represent a majority of both the total equity of the entity and the total voting power of the entity for the purpose of electing directors, the general partner, or principal officers; and*
    - *(iii) The subsidiary, joint venture, or partnership entity has been certified by the Small Business Administration under the 8(a) or small disadvantaged business program."*
- **Paraphrase:** Thus, to be certified as a DBE, the ANC firm must meet all of the following to show that it is an eligible ANC-owned firm and certified by SBA:
  1. **ANCSA-sanctioned ANC:** The firm's parent company must be ANCSA-sanctioned;
  2. **Majority Ownership/Voting:** The parent company must own a majority interest (shares and voting power) of the subsidiary entity that is applying for DBE certification; and
  3. **SBA Certified:** The subsidiary, joint venture, or partnership entity has been certified by the Small Business Administration under the 8(a) or small disadvantaged business program.

DOT Guidance for Certified ANCs: What Documentation Proves Certification?

- **Context:** Demonstrating certification by the SBA has been the source of confusion and inconsistent implementation, so DOT also offered guidance on what kinds of documentation must be accepted as evidence of the required SBA certification of a firm's 8(a) or SDB status.
  - This is especially important since DOT also clarified that self-certification will be accepted.

- **DOT Question 2:** *How do UCP recipients that are certifying agencies determine that an ANC firm is certified by the SBA?*
  - **DOT Answer:** "*An ANC firm is considered certified by the SBA if the certifying agency finds that the ANC firm meets the requirements of (i) and (ii) above, and the certifying agency finds that it satisfies any* ***one*** *of the following factors:*
    1. *The ANC firm provides documentation that it is a current participant in the SBA's 8(a) Business Development program;*
    2. *The ANC firm provides documentation that it has been certified by SBA as a SDB within three years of the date it self-certifies as an SDB;*
    3. *The ANC firm provides documentation that it has received certification from another Federal procuring agency that it qualifies as an SDB;*
    4. *The ANC firm provides documentation that it has submitted an application for SDB certification to a Federal procuring agency and has not received a negative determination regarding that application;*
    5. *The certifying agency has received correspondence from the SBA, pursuant to 13 CFR 121.1001(b)(6), that the ANC firm meets the SBA's applicable size standard for participation in the SBA SDB program; or*
    6. *The ANC firm provides correspondence from the SBA, pursuant to 13 CFR 121.1001(b)(7), that the ANC firm meets the SBA's applicable size standard for participation in the SBA SDB program.*"

DOT Guidance for Certified ANCs: What Documentation Proves Certification? (con't)

- Thus, DOT requires that ANCs provide/arrange for **one** of the listed types of documentation to **prove SBA 8(a)/SDB Certification:**
  - 8(a) Certification: Current participant in the 8(a) program
  - SDB Certification:
    - SDB certification from SBA within three years of the date it self-certifies as an SDB
    - Certification from another Federal procuring agency that it qualifies as an SDB
    - Documentation it has submitted an application for SDB certification to a Federal procuring agency and has not received a negative determination regarding that application.
  - Size/SDB Certification:
    - Size determination: Certifying agency has received correspondence from the SBA that the ANC firm meets the SBA's applicable size standard for participation in the SBA SDB Program.
    - ANC firm provides correspondence from the SBA that the ANC firm meets the SBA's applicable size standard for participation in the SBA SDB Program.

Qualifications for Non-Certified ANCs: Overview of "The Hard Way"

- For uncertified ANC firms, there are many issues to qualifying as a DBE
- **Two Separate Size Standards (must meet both!)**
  - **SBA Based:** Firms must meet the applicable SBA NAICS Size Standard, including code for the type of work sought and the firm's primary NAICS code.
  - **DOT-based:** Firms must also fall below the DOT threshold of $23.98 million average annual gross receipts over the firms previous three FYs
  - **Affiliation**
    - DOT DBE regulations require usage of SBA's affiliation regulations
    - However some state regulators erroneously argue SBA affiliation exceptions do not apply to DBE eligibility requirements and apply ANC affiliates sizes to the DBE-applicant's size qualification

Qualifications for Non-Certified ANCs: Overview of "The Hard Way" (con't)

- **Control**
  - DOT DBE regulations state DBE firms must be **independent businesses** where, among other factors,
    - disadvantaged owners must hold the **highest officer position** in the company,
    - disadvantaged owners must **control the board of directs**, and
    - provide only a limited role for non-disadvantaged individuals.
  - Control regulation also contains specific limitations regarding outside employment, technical knowledge, part-time work, licensure, transfer of ownership, and equipment ownership.

- **Ongoing Controversy:** Should ANCs be subject to different control rules, even if not "certified" applicants, because of ANCSA?
  - ANCSA states:
    - *"**For all purposes of Federal law**, direct and indirect subsidiary corporations, joint ventures, and partnerships of a Native Corporation…shall be considered to be **entities owned and controlled by Natives and a minority and economically disadvantaged business enterprise**…"* 49 U.S.C. § 1626.
  - Arguably, ANC applicants should be considered socially and economically disadvantaged, and could be controlled by non-disadvantaged individuals, without compromising its DBE eligibility status.
  - DOT guidance does not address the gray area of non-certified ANCs.

Practice Tips: What to Include in State DBE Applications

- **Uniform Application Form** does not apply to Certified ANC applicants, so make sure your firm provides evidence of all applicable criteria. States may ask for additional information.
- **DOT Guidance & Narrative:**
  - Include a copy of the DOT DBE Guidance for ANC-Certified applicants
  - Include a separate narrative explanation in the same format as the DOT Guidance Q&A regarding how your firm meets each applicable criteria in the guidance and cite the relevant documents included in your application for each requirement.
- **ANCSA-sanctioned:** Cite, explain, and include documentation that your ANC was sanctioned under ANCSA.
  - Provide documentation regarding your firm, its parent company, and any "holding companies" in between. Explain organization and include documents necessary to demonstrate that the ANC has requisite control over your firm. Documentation should include company names, percentages of ownership, and the relationship of companies to each other. (E.g. annotated organization charts.)
- **Cite Affiliation Exceptions:**
  - Include copies of the relevant DOT (49 CFR 26.5) and SBA regulations (13 CFR 121.103).
  - Remind state implementers that DOT regulations (49 CFR 26.5) dictate that SBA affiliation rules control, and explain that your firm is not considered affiliated with any other entities within the corporate family under 13 CFR 121.103(b)(2), the applicable ANC affiliation exception in your DBE application.
- **For Non-Certified ANCs**, assess whether the costs are worth the expected return. Expect an up-hill battle. You may have to make major changes to your firm's organizational and management structures to qualify, and those changes might be unacceptable compromises for ANC management to make.

Defense of Trade Secrets Act

DTSA

Defense of Trade Secrets Act

- **Before DTSA**
  - State law - Companies had to make agreements with employees, etc. that complied with applicable state laws to protect confidential information.
  - Federal law applied only when government contracts were involved.
- **New Civil Cause of Action:** DTSA gives owners of trade secrets that are misappropriated a civil cause of action in the federal courts in any situation involving a trade secret that "is related to a product or service used in, or intended for use in, interstate or foreign commerce."
  - Scope of the statute is broad (in some respects broader than many state laws). It **supplements state law, it does not preempt state law.**
- **New Whistleblower Protections:** Includes whistleblower protection from liability for employees
- **Remedies:** A variety of remedies are available under the statute
  - Court may not grant injunctive relief that prevents companies from barring ex-employees from accepting new employment, even when employee is taking knowledge of trade secrets

Defense of Trade Secrets Act (con't)

TAKE-AWAYS for Employers

- **Update Existing Agreements**
  - **Insert new Mandatory Notice:** Employers required to notify employees of the new law's whistleblower protections in "any contract or agreement with an employee that governs the use of a trade secret or other confidential information."
    - NOTE: Failure to provide this notice, precludes employer from recovering punitive damages or attorneys' fees in action brought against an employee under the new law.
  - **Review NDA/Confidentiality Agreements Coverage:** Ensure that all employees, consultants, subcontractors, and independent contractors that have access to trade secrets/confidential information are covered by an NDA or contract provision.
- **Revise Hiring Procedures:** When hiring individual from a competitor, consider asking (and documenting):
  - whether the applicant signed any confidentiality or non-disclosure agreements ("NDA") or whether confidentiality provisions were included in his employment agreement;
  - whether the applicant had access to trade secrets or other confidential information; and
  - what documents (if any) the applicant intends to bring with him.

Questions & Discussion

Part 2: SBA REGULATORY UPDATE

Overview

Changes Applicable to Small Businesses

- Changes to Subcontracting Limitations
- Affiliation
  - New "Contractual Relations" Affiliation Exception for ANCs, Tribes, NHOs, and CDCs**
  - Identity of Interests Based on Economic Dependence & New Rebuttable Presumption**
- Issue Spotlight: Overseas Contracting

Changes to 8(a) Program

- Issue Spotlight: Follow-On Contracts
  - Rule Update: New Construction Contract Requirements & Adverse Impact Analysis
- Rule Update: Individuals May Not Manage More Than Two Tribally-Owned or ANC-Owned 8(a) Program Participants at Once
- Issue Spotlight: Increased Scrutiny on NAICS Codes
  - SBA May Now Unilaterally Change 8(a) Firms' Primary NAICS Codes

Changes to Subcontracting Limitations

- Shift in Focus and Standard
- SBA's New Rule
- Cost of Materials Exclusion
- Calculating Subcontracting Limitations
- Mixed Procurements
- General Provisions
- Applicability
- Similarly Situated Entity (SSE) Exclusion
- Reporting Requirements
- Penalties for Non-Compliance
- Subcontracting Plans
- Performance of Work Requirements for JVs

Shift in Focus and Standard

- Shift away from prime self-performance minimums. Instead, regulations are phrased as the maximum that the Prime may subcontract.
- **New standard** (based on contract amount paid, not labor).
- **Goal is the same** – "To ensure that a certain amount of work is performed by a small business concern that qualified for a small business program set-aside or sole source procurement due to its socioeconomic status." 81 Fed. Reg. at 34,244.
- **Percentages Same, but Expressed differently.** SBA proposes to keep the same percentages, but they are expressed in terms of the maximum allowed to be subcontracted, instead of the previous approach of the minimum amount that must be self-performed.
  - For services and supplies: 50% of the award amount received by the prime contractor.
  - 15% for general construction.
  - 25% for specialty trade construction.
- New exclusion for Similarly Situated Entities (SSEs)
- New compliance and enforcement of Subcontracting Plans provision
- New penalties for non-compliance

SBA's New Rule

13 CFR 125.6(a)

- **The Regulation states:** "…[A] small business concern must agree that:
  - *(1) In the case of a contract for **services** (except construction), it will not pay more than 50% of the amount paid by the government to it to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 50% subcontract amount that cannot be exceeded.*
  - *(2)(i) In the case of a contract for **supplies or products** (other than from a nonmanufacturer of such supplies), it will not pay more than 50% of the amount paid by the government to it to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 50% subcontract amount that cannot be exceeded. Cost of materials are excluded and not considered to be subcontracted…*
  - *(3) In the case of a contract for **general construction**, it will not pay more than 85% of the amount paid by the government to it to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 85% subcontract amount that cannot be exceeded. Cost of materials are excluded and not considered to be subcontracted.*
  - *(4) In the case of a contract for **special trade contractors**, no more than 75% of the amount paid by the government to the prime may be paid to firms that are not similarly situated. Any work that a similarly situated subcontractor further subcontracts will count towards the 75% subcontract amount that cannot be exceeded. Cost of materials are excluded and not considered to be subcontracted.*

Cost of Materials Exclusion

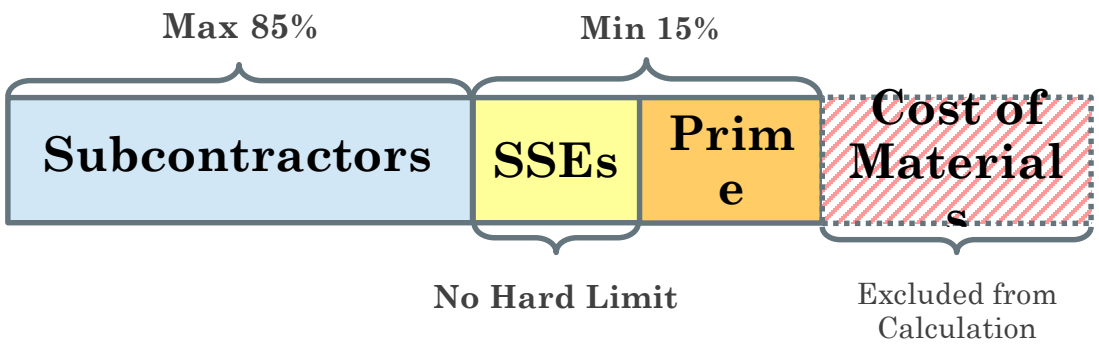
- **Cost of Material Exclusion** - Applies only to supplies, construction, and specialty trade construction.
- **Services** – While cost of materials exclusion is not applicable to service contracts, it is not needed, because those costs are excluded in a different way.
  - **The 50% subcontracting limitation for service contracts only applies to the services portion of the contract.**
  - "any costs associated with supply items are excluded from that analysis."
  - "[A]ll costs associated with providing the services, including any overhead or indirect costs associated with those services, must be included in determining compliance."

Calculating Subcontracting Limitations

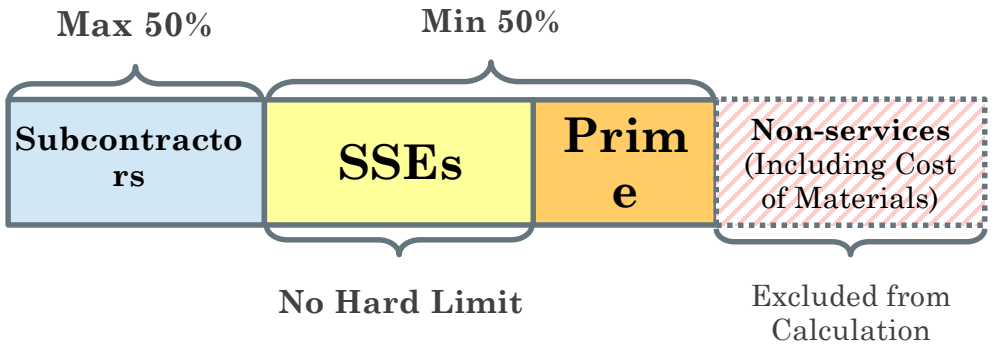
- Similarly Situated Entities are **excluded** from subcontracting limitations
  - "[T]he NDAA deems any work done by a similarly situated entity not to constitute "subcontracting" for purposes of determining compliance with the applicable limitation on subcontracting."
  - However, any work that a similarly situated subcontractor further subcontracts will count towards the 50% subcontract amount that cannot be exceeded.

Similarly Situated Entity
A subcontractor that has the same small business program status as the Prime and is small for the NAICS code that the Prime assigned to the SSE's subcontract.

Construction Contract w/ SSE Exemption



Services Contract w/ SSE Exemption



Mixed Procurements

- Mixed Procurements
  - e.g. procurement for services and supplies
- Guidance:
  - First, CO must determine which category (services or supplies) has the greatest percentage of contract value and then assign the appropriate NAICS code. See 13 CFR 125.6(b).
  - NAICS code selected dictates applicable subcontracting limitations, which would only apply to "principal purpose of the prime contract."
- Thus, on a services contract, "a prime contractor can subcontract all of the supply components to any size business."

Mixed Procurements (SBA Examples)

- **Supplies Contract with Services Component.** A procuring agency is acquiring both services and supplies through a small business set-aside. The total value of the requirement is $3,000,000, with the supply portion comprising $2,500,000, and the services portion comprising $500,000. The contracting officer appropriately assigns a manufacturing NAICS code to the requirement. The cost of material is $500,000. Thus, because the services portion of the contract and the cost of materials are excluded from consideration, the relevant amount for purposes of calculating the performance of work requirement is $2,000,000 and the prime and/or similarly situated entities must perform at least $1,000,000 and the prime contractor may not subcontract more than $1,000,000 to non-similarly situated entities.

- **Services Contract with Supplies Component.** A procuring agency is acquiring both services and supplies through a small business set-aside. The total value of the requirement is $3,000,000, with the services portion comprising $2,500,000, and the supply portion comprising $500,000. The contracting officer appropriately assigns a services NAICS code to the requirement. Thus, because the supply portion of the contract is excluded from consideration, the relevant amount for purposes of calculating the performance of work requirement is $2,500,000 and the prime and/or similarly situated entities must perform at least $1,250,000 and the prime contractor may not subcontract more than $1,250,000 to non-similarly situated entities.

General Provisions

- **Responsibility:** Compliance will be considered an element of responsibility and not a component of size eligibility.
- **Independent Contractors:** Work performed by an independent contractor shall be considered a subcontract, and may count toward meeting the applicable limitation on subcontracting where the independent contractor qualifies as a similarly situated entity.
- **Period of Compliance:**
  - General Contract: The period of time used to determine compliance for a total or partial set-aside contract will be the base term and then each subsequent option period.
  - Order: For an order set aside under a full and open contractor a full and open contract with reserve, the agency will use the period of performance for each order to determine compliance unless the order is competed among small and other-than-small businesses (in which case the subcontracting limitations will not apply).
    - The contracting officer, in his or her discretion, may require the concern to comply with the applicable limitations on subcontracting and the nonmanufacturer rule for each order awarded under a total or partial set-aside contract.

Applicability

- Subcontracting Limitation rules apply to:
  - Small Business set-aside contracts valued at $150,000 or more, as a general rule.
  - All Program-Specific set-asides, regardless of dollar value.
    - E.g. 8(a), WOSB/EDWOSB, HUBZone, SDVO
  - **SBTAs:** Subcontracting limitations apply to the combined effort of members of a Small Business Teaming Agreement, not to members individually.
- Limitations on Subcontracting DO NOT apply to:
  - Small business set-aside contracts valued at 3,500 – 149,999.99
  - Subcontracts (except where a prime is relying on a similarly situated entity to meet the applicable limitations on subcontracting).

Similarly Situated Entity (SSE) Exclusion

- **SSE work is not "subcontracting"** for purposes of determining compliance with the applicable limitation on subcontracting.
- **Purpose of exclusion:** Subcontracts between a small business prime contract and a SSE subcontractor are excluded from the limitations on subcontracting calculation because it does not further the goals of SBA's government contracting and business development programs to penalize small business prime contract recipients that benefit the same small business program participants through subcontract awards.
- **Exclusion is applicable only to first-tier subcontractors.** Work that is not performed by the employees of the prime contractor or employees of first tier SSE subcontractors will count as subcontracts performed by non-SSEs.

Similarly Situated Entity (SSE) Exclusion

What qualifies as a Similarly Situated Entity?

- ***"Similarly situated entity*** is a subcontractor that has the same small business program status as the prime contractor."
  - For a small business set-aside, partial set-aside, or reserve a subcontractor that is a small business concern…
  - For an 8(a) requirement, a subcontractor that is an 8(a) certified Program Participant
  - **Size of SSE:** In addition to sharing the same small business program status as the prime contractor, a similarly situated entity must also be small for the NAICS code that the prime contractor assigned to the subcontract that the subcontractor will perform. ***13 CFR 125.1.***
- **SSE exclusion from Affiliation under Ostensible Subcontractor Rule** – final rule adopts proposed rule language. The final rule excludes subcontractors that are similarly situated from affiliation under the ostensible subcontractor rule.

Reporting Requirements

- **FAR 52.204-10:** SBA will rely on this existing FAR clause, which already requires prime contractors to report on subcontracting activities.
- **Certification:** SBA will rely on existing requirements for prime contractors to agree to comply with limitations on subcontracting generally in connection with the offer in order to be awarded a set-aside contract as a small business.
- **Streamlined for Now:** In the final rule, SBA declined to include several provisions considered in the proposed rule regarding compliance reporting, written agreements for SSEs, and separate certification.
- **Future Comment Opportunity:** SBA intends to issue a proposed rule to request public comment on the issue of whether ALL small businesses (not only those that are using SSEs to perform a contract as in previous proposed rule) should be required to report on compliance with limitations on subcontracting set-aside.

Penalties for Non-Compliance

Failure to Comply with Limitations on Subcontracting Generally

- SBA's Final Rule provided for controversial penalties regarding non-compliance with limitations on subcontracting and SSE subcontracts.
  - Revised § 125.6(h) provides: *Penalties. Whoever violates the requirements set forth in paragraph (a) of this section shall be subject to the penalties prescribed in 15 U.S.C. 645(d), except that the fine shall be treated as the greater of $500,000 or the dollar amount spent, in excess of permitted levels, by the entity on subcontractors. A party's failure to comply with the spirit and intent of a subcontract with a similarly situated entity* ***may be considered a basis for debarment*** *on the grounds, including but not limited to, that the parties have violated the terms of a Government contract or subcontract pursuant to FAR 9.406–2(b)(1)(i) (48 CFR 9.406–2(b)(1)(i)).*
- SBA on Non-Discretionary Monetary Penalties
  - Penalties are defined in statute. So while many consider them harsh ($1 over subcontracting limitations will result in $500,000 fine), SBA has no discretion/authority to make them more moderate.
  - SBA: *"[C]oncerns that violate the limitations on subcontracting are subject to the penalties listed in 15 U.S.C. 645(d) except that the fine associated with these* ***penalties will be the greater of either $500,000 or the dollar amount spent in excess of the permitted levels for subcontracting****."*
- **PRACTICE TIP:** Due to the lag of updating the FAR in light of the new SBA regulations, SBA has publically noted that it recommends that contractors ask contracting officers which subcontracting limitations (old in FAR or new in SBA regulations) will be applicable to the RFP. If the RFP is unclear, ask for the RFP to be clarified and craft a proposal based on CO's election. BHBC recommends complying with regulations (also in the statute).

Penalties for Non-Compliance – SSE Contracts

- **Failure to Comply with Spirit and Intent of SSE Subcontract - Penalty Discretionary.**
  - SBA kept debarment as possible penalty, but noted that violation of the spirit and intent of the subcontract with a similarly situated entity is something SBA **may** consider as basis for debarment, but is not required to consider for debarment. SBA notes that SBA would NOT consider suspension or debarment for violation when the prime made good faith representation but unforeseen circumstances led to violation.
  - **Opportunity to Respond:** If SBA considers a violation of this SSE provision as basis for debarment, entity will have opportunity to respond.

Subcontracting Plans

- *Section 1653(a)(2) of the NDAA states that the head of the contracting agency shall ensure that the agency collects, reports, and reviews data on the extent to which the agency's contractors meet the goals and objectives set out in their subcontracting plans.*
- **Enforcement: Material breach of contract** and potential impact on **past performance evaluation** for failure to provide written corrective action plan as specified or for failure to make good faith effort to comply with subcontracting plan.
- **Notification to Potential Subcontractors:** Primes must notify SBCs that are identified as potential subcontractors in a proposal, bid, offer or subcontracting plan connected with a Federal contract. SBA will establish a reporting mechanism for fraudulent activity or bad faith.

Performance of Work Requirements for JVs

- Two levels of performance of work requirements:
  - Protégé's Performance of Work: Minimum amount of the JV's work that the Protégé must perform.
  - Limitations on Subcontracting: Minimum amount of work that the JV must perform of the total contract's work (generally applicable)

JV Protégé Performance of Work Requirements & Subcontracting Limitations for JVs

Protégé's Performance of Work - Current Performance of Work Requirements for 8(a) Mentor-Protégé Joint Ventures

- For any 8(a) contract, the JV must perform the applicable percentage of work required by 13 CFR § 124.510.
- In an unpopulated joint venture both the 8(a) and non-8(a) partners are technically subcontractors.

8(a) JV partner(s) must perform at least 40% of the work performed by the joint venture.

- Work performed by 8(a) JV partners must be more than administrative or ministerial functions so that they gain substantive experience.
- Work done by the partners will be aggregated and the work done by the 8(a) partner(s) must be at least 40% of the total done by all partners.
- In determining the amount of work done by a non-8(a) partner, all work done by the non-8(a) partner and any of its affiliates at any subcontracting tier will be counted.

Subcontracting Limitations

- **JV = Prime Contractor.** For purposes of compliance with subcontracting limitations, the JV is considered the Prime, so the work done by both/all JV partners will determine how much work is performed by the "prime" compared to subcontractors.
- **Example:** On a Services contract, the JV must perform at least 50% of the contract's award amount received by the JV contractor, and the protégé must perform at least 40% of the work done by the JV (thus protégé performs at least 20% of the award).

Changes to Affiliation Rules

- SBA Adds to Definition of the Common Administrative Services Exception to Affiliation
- New "Contractual Relations" Affiliation Exception for ANCs, Tribes, NHOs, and CDCs under Affiliation Regulations regarding Identity of Interests Based on Economic Dependence & New Rebuttable Presumption

Common Administrative Services Affiliation Exemption: Examples of Qualifying Activities

SAFE	POSSIBLY SAFE	NOT PERMISSIBLE
• Bookkeeping • Payroll • Recruiting • Human resource support • Cleaning services • Duties unrelated to contract performance/ management that do not interfere with the control of the subject firm	• Services that are "administrative in nature" • Record retention not related to specific contract • Database maintenance for awarded contracts • Regulatory compliance monitoring • Template development • Assisting with invoice preparation • Identifying procurement opportunities IF subsidiary is involved in business development and prepares the offer, controls the technical and contract-specific portions of offer preparation, controls employee assignments, and controls contract performance logistics.	• "Actual and direct day-to-day oversight and control" of contract performance • Negotiating directly with government • Project scheduling • Hiring and firing of employees • Employee assignments on contracted work • Logistics of contract performance

New "Contractual Relations" Affiliation Exception for ANCs, Tribes, NHOs, and CDCs

- **New Affiliation Exception:** "*A business concern owned and controlled by an Indian Tribe, ANC, NHO, CDC, or by a wholly-owned entity of an Indian Tribe, ANC, NHO, or CDC, is* ***not considered to be affiliated with another concern owned by that entity based solely on the contractual relations between the two concerns.***" 13 CFR 121.103 (f)(2)(ii).
- **Purpose of new Exception:** SBA commented: "*The Small Business Act and SBA's rules clearly recognize that ANC, NHO, CDC, and Tribally-owned concerns will provide assistance to sister entities, and it does not make sense to find affiliation based on economic dependence among such concerns.*"
- **Context:** This new exception was included as part of the revisions to the regulations regarding affiliation based on Identity of Interests and Economic Dependence.

Identity of Interests Based on Economic Dependence & New Rebuttable Presumption

- **Rebuttable presumption of economic dependence**
  - *"if a firm derives **70%** or more of its revenue from another firm over the previous fiscal year, SBA will presume that the one firm is economically dependent on the other and, therefore, that the two firms are affiliated."*
  - SBA stressed the presumption is rebuttable for a reason and gave many examples (including OHA cases) where presumption would be rebutted.

- **Timeframe**: SBA will use a three-year measuring period (instead of the proposed one year); this is more consistent with the existing 3-year time frame for measuring size generally.

- **Potential Grounds for Rebuttal:**
  - Start-Ups: "SBA does not want this new rule to negatively impact start-ups or any other company that operates in a unique industry. That is precisely why this is not a bright line rule, but a rebuttable presumption. This rebuttable presumption is based on OHA cases, and OHA has in fact rebutted the presumption in appropriate circumstances. For instance, OHA has held that the mechanical application of the economic dependence rule is erroneous when a startup has only been able to secure one or two contracts. *Size Appeal of Argus & Black, Inc.,* SBA No. SIZ–5204 (2011)."
  - ANC/Tribal Corporate Families: "In addition, OHA has held that where the receipts from an alleged affiliate are not enough to sustain a firm's business operations, and the firm is able to look to other financial support from its Alaska Native Corporation (ANC) affiliates to remain viable, the fact that the firm received more than 70% of its receipts from its alleged affiliate is not sufficient to establish affiliation. *Size Appeal of Olgoonik Solutions LLC,* SBA No SIZ–5669 (2015)."

Issue Spotlight: Overseas Contracting

- Explicit Authorization for Overseas Contracting under SBA Programs
  - Recent Rule Explained: "Rule of Two" Applies "Regardless of the Place of Performance"
  - 8(a) Contracts Authorized "Regardless of Place of Performance"

Recent Rule Explained: "Rule of Two" Applies "Regardless of the Place of Performance"

- Under an October 2013 rule change, contracts performed overseas are subject to the "Rule of Two" mandate.
- **Change Explained:** SBA explained its reasoning for this rule change in the Final Rule summary, since this rule would be inserting additional complementary language into the program-specific portions of the regulations.
- **Changes Respond to GAO's 2013 *Latvian* decision**
  - GAO denied a protest claiming an overseas contract should have required "Rule of Two" set aside, asserting that SBA regulations were silent on the program's application overseas.
  - SBA soon proactively changed their regulations to say small business programs could be utilized "regardless of the place of performance" to 13 CFR 125.2.
  - Continued uncertainty spurred SBA to expand this language throughout the small business contracting regulations, including here.

Recent Rule Explained: "Rule of Two" Applies "Regardless of the Place of Performance" (con't)

- **Complications:**
  - Language is contrary to the FAR 19.000(b)'s language that the FAR's small business program regulations do not apply overseas.
  - Major change which could lead to potential backlash from other agencies, cause practical challenges in setting aside overseas contracts for small businesses, and create general confusion.
  - Language in the rule indicates a "mandate," but SBA recognized that the rule changes simply allow agencies to use small business programs overseas.
    - Rule: "Small business concerns must receive any award (including orders, and orders placed against Multiple Award Contracts) or contract, part of any such award or contract, and any contract for the sale of Government property, regardless of the place of performance, which SBA and the procuring or disposal agency determine to be in the interest of…"
    - *SBA explained: "Specifically, SBA made wholesale changes to 13 CFR 125.2 on October 2, 2013. As a result, SBA issued a final rule recognizing that small business contracting **could** be used 'regardless of the place of performance.' 13 CFR 125.2(a) and (c)."*

Overseas Contracting: 8(a) Contracts Authorized "Regardless of Place of Performance"

- SBA also added *regardless of the place of performance* language to its program-specific regulations for:
  - 8(a) Program
  - SDVO SBC
  - HUBZone
  - Woman-Owned Small Businesses
- Language here is *permissive*.
  - Clarifies SBA's interpretation that agencies *may* utilize these programs regardless of the place of performance, essentially allowing small business contracting programs to be used overseas.

Changes to the 8(a) Program

- Issue Spotlight: Follow-On Contracts
  - Rule Update: New Construction Contract Requirements & Adverse Impact Analysis
- Rule Update: Individuals May Not Manage More Than Two Tribally-Owned or ANC-Owned 8(a) Program Participants at Once
- Issue Spotlight: Increased Scrutiny on NAICS Codes
  - SBA May Now Unilaterally Change 8(a) Firms' Primary NAICS Codes

Issue Spotlight: Follow-On Contracts

Issue Spotlight: New Contracts v. Follow-On Contracts

- **Rule: No Sole-Source Follow-On Contracts from Sister Companies**
  - Once an applicant is admitted to the 8(a) Program, it may not receive an 8(a) sole-source contract that is a follow-on contract to an 8(a) contract that was performed immediately previously by another Participant (or former Participant) owned by the same ANC or Tribe.
- **New v. Follow-On?** To determine whether a contract is considered a follow-on contract (and thus may not be performed by a sister company of the incumbent 8(a)), one must first consider whether the contract is a new requirement or a follow-on contract.
- **Trend:** SBA seems to applying increased scrutiny to this area, trying to prevent follow-on contracts from sister companies.
- **Follow-on Contract Issue in Other Contexts:** This issue also arises in other contexts, such as when SBA considers whether a contract is "new" and may be released from the 8(a) Program. Issues of new versus modified contract requirements arise under the FAR as well.

What is a "new" contract requirement?

- 13 CFR 124.504(c)(1)(ii): SBA provides guidance of what is considered a new contract requirement.
  - **Definition of a "New" Contract Requirement.** SBA regulations provide that "a new requirement is one which has not been previously procured by the relevant procuring activity." According to the regulations, if the requirement is new it could not have been performed previously by a small business, and therefore its acceptance into the 8(a) program could not have an adverse impact on any small businesses.
  - **Expansion/Modification of Existing Requirement.** As a general matter, "the expansion or modification of an existing requirement will be considered a new requirement where the magnitude of change is significant enough to cause a **price adjustment of at least 25%** (adjusted for inflation) or to require **significant additional or different types of capabilities or work.**" While a decrease in the scope of the work could arguably be considered "significant," adding **new types of work** to the contract requirement presents a stronger argument because it may require new skills beyond the capabilities of the current contract vehicle and incumbent. This new work could be an addition to or substitute for the original work requirements in the contract.
    - **Decrease in Scope of Work:** A decrease in the scope of work by contrast might cause a challenger to invoke the Competition in Contracting Act (CICA) to claim that if the original scope of work had been small from the beginning, other businesses might have been able to compete and provide the small scope of services that would not have been able to provide the wider scope of services. Therefore, if the scope of work was originally broader than the proposed modification, more companies would have been able to compete (and perhaps win) the award.

"New" Construction Contract Requirements Recurring IDIQ Construction & Adverse Impact Analysis

- **Construction Contracts Overview.** Construction contracts, such as those for building specific structures, are generally considered new requirements "by their very nature," because they are contracts to construct new structures.
- **New Rule:** SBA updated its rule regarding what constitutes a new requirement in the construction contract context. SBA is amending 124.504 to clarify when a procurement for construction services is considered a "new" requirement, which would in turn require an adverse impact analysis.
  - **Recurring IDIQs:** In the final rule, SBA clarifies that, generally, the building of a specific structure is a new requirement, but that **recurring IDIQs for construction are not new requirements and therefore would not require an adverse impact analysis.**
  - **Case-by-case Determination:** Whether a construction requirement is new or recurring will be decided on a case-by-case basis, and, if a disagreement occurs, the rule provides a process by which SBA may file an appeal with the procuring agency.
  - **No Presumption:** There is no presumption of new or recurring requirement in this situation; the rule is neutral.

What is a follow-on contract?

- The term "follow-on contract" is not explicitly defined in these SBA regulations.
- Based on the information regarding "new" contract requirements above, we can reasonably deduce that a follow-on contract (arguably) has the following attributes:
  - Is a requirement that has been previously procured by the relevant procuring activity.
  - Involves a price adjustment, in any, of less than 25% in the contract value.
  - Does NOT involve significant additional capabilities or work compared to previous contract.
  - Does NOT involve different types of capabilities or work compared to the previous contract.
  - In the case of construction contract, is NOT (generally) a requirement for a new structure.

Next Steps & Practice Tips

- **TREND:** SBA is becoming adversarial on the issue of whether a follow-on contract exists if there is an connection to a sister company's pre-existing 8(a) contract.

- **Be Prepared for a Fight, but Try to Prevent One**
  - **Document and explain** why the contract at issue is a new requirement and not a follow-on contract. Point to changes/differences in scope, price, agency customer, increase in capabilities/skills needed to perform work, etc.
  - **Don't Underestimate the Importance of the First SBA Decision-Maker.** If there is any question that the contract might be considered a follow-on contract by SBA, provide documentation to SBA directly or through the procuring agency. Get information in front of the decision-maker at SBA, since it may be difficult to get that person to change his/her mind later AND it will be very difficult to get that original decision overturned later.

- **Things to Keep in Mind**
  - **No Right to Sole Source Contract.** There is no "right" to an 8(a) contract, even where the agency is specifically requesting your company. There is no formal appeals procedure for these kinds of decisions. So "play nice" with SBA contacts, as agency discretion rules in this area.
  - **Inconsistent Implementation.** New vs. Follow-On Determinations are likely to vary with decision-maker.
  - **Back-Up Plan:** Have a back-up plan in case SBA refuses to approve the contract for the 8(a) Program on the grounds it is a prohibited follow-on contract from a sister company.

Next Steps & Practice Tips (con't)

- **Back-Up Plan Options**
  - **Compete for the Contract.** The follow-on contract prohibition only applies to sole source 8(a) awards. Sister companies are at liberty to *compete* for follow-on contracts. This requires that the agency is willing to take the time and effort to compete the contract.
    - The 8(a) participant sister company could compete for the requirement within the 8(a) Program.
    - Alternatively, the incumbent 8(a) graduate could ask SBA to release the requirement from the 8(a) Program for a small business set-aside. *See* 13 C.F.R. § 124.504(d).
  - **Find an 8(a) Joint Venture Partner/Protégé.**
  - **Be a subcontractor to a new 8(a).** Be cautious of the ostensible subcontractor risk, and ensure 8(a) firm does substantive work and is not too dependent on incumbent/incumbent sister company.

SBA Regulations Updated: Two 8(a) Limit for Day-to-Day Managers

Rule Updated to Match Statute: Individuals May Not Manage More Than Two 8(a) Program Participants at Once

- **The New Rule:** 13 CFR 124.109(a)(c)(4)(iii).
  - ***(iii) The individuals responsible for the management and daily operations of a tribally-owned concern cannot manage more than two Program Participants at the same time.***
    - *(A) An individual's officer position, membership on the board of directors or position as a tribal leader does not necessarily imply that the individual is responsible for the management and daily operations of a given concern. SBA looks beyond these corporate formalities and examines the totality of the information submitted by the applicant to determine* ***which individual(s) manage the actual day-to-day operations*** *of the applicant concern.*
    - ***(B) Officers, board members, and/or tribal leaders may control a holding company overseeing several tribally-owned or ANC-owned companies, provided they do not actually control the day-to-day management of more than two current 8(a) BD Program Participant firms.***
- **Applicability:** Applies to tribal and ANC-owned participants as per 13 CFR 124.109(a).
- **Based on Pre-existing Statute:** While the general rule in (iii) already appears in the Small Business Act and federal statutes, it was not reflected in SBA regulations. Furthermore, these regulations include more guidance as to how SBA interprets the originating statute and rule.
- **Totality of Information:** Codifies current SBA practice that in determining who manages actual day-to-day operations of a concern, SBA looks beyond corporate formalities and titles and examines the totality of the circumstances.

Individuals May Not Manage More Than Two 8(a) Program Participants at Once (con't)

- **Compliance Tips:**
  - **Compliance Audit:** Review current organizational structure and responsibilities to ensure enterprise does not violate this rule.
  - **GM Autonomy:** GMs of 8(a) firms (not executives at parent companies) need to manage the day-to-day operations of the 8(a) firms. This may require 8(a) GMs to have more autonomy than other firms in the corporate family depending on the management structure.
  - **Update position descriptions** and other documentation reflecting the 8(a) leaders who do and do not have day-to-day control over operations.
  - **Training:** Educate management at all levels within the corporate family regarding the implications of this rule.
  - **Periodically review** assignment of responsibilities of corporate leaders to ensure no managers are managing day-to-day operations of more than two 8(a) firms.

Issue Spotlight: Increased Scrutiny on NAICS Codes

- Rule Change: SBA May Now Unilaterally Change 8(a) Firms' Primary NAICS Codes
- Issue Spotlight: Two-Year Rule & NAICS Subcategories

Rule Change: SBA May Now Unilaterally Change 8(a) Firms' Primary NAICS Codes

- Proposed change codifies current SBA practice of changing a firm's NAICS code when SBA determines that a firm's primary industry has evolved.
  - MAJOR change to the current regulations, which allow only the Participant itself to change its primary NAICS code.
  - Prompted by fear the current system allows a firm to select a primary NAICS code different from any other Participant owned by that same entity and then perform majority of its work in the same primary NAICS code as the other participant.
    - Previously, no requirement for Participant to actually perform work in the NAICS code under which its program entry was certified.
- **New Rule:** *"SBA may change the primary industry classification contained in a Participant's business plan where the greatest portion of the Participant's total revenues during the Participant's last three completed fiscal years has evolved from one NAICS code to another."*
- **Process:**
  - SBA will review primary NAICS codes as part of the firm's annual review process.
  - When SBA determines that such change is appropriate, SBA notifies Participant of intent to make a change and give firm opportunity to respond.
  - Participant may challenge by demonstrating why it believes its chosen primary NAICS continues to be appropriate.
    - i.e. new contracts received since end of the last fiscal year, if the firm made good faith efforts to obtain contracts in its primary NAICS code, etc.
  - No additional appeals process!
- SBA declined to make automatic changes NAICS code changes based on federal database reports.

Rule Change: SBA May Now Unilaterally Change 8(a) Firms' Primary NAICS Codes (con't)

New rule also includes specific guidance on dissuading SBA to make a unilateral change:

- (e)(2)(ii)A Participant may challenge SBA's intent to change its primary industry classification by **demonstrating why it believes the primary industry classification contained in its business plan continues to be appropriate, despite an increase in revenues in a secondary NAICS code beyond those received in its designated primary industry classification**. The Participant should identify:
  - All non-federal work that it has performed in its primary NAICS code;
  - any efforts it has made and any plans it has to make to receive contracts to obtain contracts in its primary NAICS code;
  - all contracts that it was awarded that it believes could have been classified under its primary NAICS code, but which a contracting officer assigned another reasonable NAICS code; and
  - any other information that it believes has a bearing on why its primary NAICS code should not be changed despite performing more work in another NAICS code.

- (iii) As long as the Participant provides a **reasonable explanation** as to why the identified primary NAICS code continues to be its primary NAICS code, SBA will not change the Participant's primary NAICS code.

- **Impact on Sister Companies following NAICS Change:** *Where an SBA change in the primary NAICS code of an entity-owned firm results in the entity having two Participants with the same primary NAICS code, the second, newer Participant will not be able to receive any 8(a) contracts in the six-digit NAICS code that is the primary NAICS code of the first, older participant for a period of time equal to two years after the first Participant leaves the 8(a) BD program.*

Issue Spotlight: Two-Year Rule & NAICS Subcategories

- **The Two-Year Rule: Prohibits sister companies from having the same primary NAICS code**
  - In addition to the one-time eligibility rule (which applies generally to 8(a) applicants), 8(a) applicants owned by ANCs and tribes must also comply with the two-year rule in 124.109(c)(3)(ii):
    - *A Tribe [or ANC] may not own 51% or more of another firm which, either at the time of application or within the previous two years, has been operating in the 8(a) program under the **same primary NAICS code** as the applicant.*
    - *A Tribe may, however, own a Participant or other applicant that conducts or will conduct **secondary business** in the 8(a) BD program under the NAICS code which is the primary NAICS code of the applicant concern.*
    - **NAICS Subcategories:** *"…the same primary NAICS code means the six digit NAICS code having the same corresponding size standard."*
  - **NOTE: Recent SBA Policy Change** – SBA can change an 8(a) firm's NAICS code without the firm's consent. This was a recent SBA internal policy shift, and now is codified in SBA rules.
- **Trend:** SBA is applying increased scrutiny to prevent sister companies in the same industry. Issues could arise during new 8(a) applications or during annual reviews (where primary NAICS code is not reflected in revenues).
- **Practice Tip:** Spot and prevent NAICS code issues before SBA interferes. Entities must create systems for tracking revenues for all 8(a) entities by NAICS code and regularly monitor for deviations from goals. Business development teams should set strategic goals using NAICS codes and monitor related progress and industry opportunities.

QUESTIONS?

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