wiley

NEWSLETTER

Roundup: Recent Changes for Small Business Contractors

February 2019

Authors

George E. Petel
Partner
202.719.3759
gpetel@wiley.law

Practice Areas

Government Contracts

Small Business Programs and Nontraditional Defense Contractors

This article addresses several recent statutory and regulatory changes that impact small business contractors and their large business partners. Some changes have been on the small business contracting community's wish list for years, including long-awaited updates to the Federal Acquisition Regulation (FAR) that the Small Business Administration (SBA) implemented years ago. The impacts of these changes should, on the whole, be positive—easing administrative burdens and mitigating some unintended consequences—but other changes may be disproportionality negative for some contractors.

Small Business Runway Extension Act of 2018

On December 17, 2018, the Small Business Runway Extension Act of 2018 was signed into law. Under the Small Business Act, a concern's average annual receipts are used to determine if the concern is considered small under a revenue-based size standard. The Runway Extension Act instructs SBA to calculate size based on a concern's average annual receipts for the past ***five*** years to determine its size status, extending the prior three-year average. The change does not impact the calculation of size status based on the number of employees, which remains the preceding twelve-month average. On December 21 the SBA issued an internal Information Notice stating its position that, because the Runway Extension Act has no effective date, the three-year rule still applies until the SBA changes its regulations.

According to the House Committee on Small Business, the purpose of the Act is to "allow small businesses at every level more time to grow and develop their competitiveness and infrastructure, before entering the open marketplace.” Many small business contractors experience sudden and rapid growth (sometimes through a single contract award) leading to a pernicious business cycle where they are no longer “small” under the SBA’s rules, but still lack the infrastructure and experience to compete large, well-established companies in full and open competitions. Extending the size calculation to five years will enable small businesses to pursue larger opportunities for growth with less fear that those opportunities may harm the business’s future.

On the other hand, companies with declining revenues (such as those with multiple-year contracts coming to an end or requiring recertification), and which would otherwise have been small again under the prior three-year calculation, would now find themselves saddled with their past success and forced to remain for a longer period of time in a full and open environment in which they may not be able to effectively compete.

Limitations on Subcontracting

The FAR Council issued a proposed rule updating FAR 52.219-14, Limitations on Subcontracting. The proposed rule would align the FAR with SBA regulations changed in 2016 to implement provisions of the FY13 National Defense Authorization Act (NDAA). The conflict between the FAR and SBA rules have been a source of frustration for both large and small businesses trying to form effective teams and to issue proper reports to the Government.

Under the limitations on subcontracting, the prime contractor must generally perform at least fifty percent of the work under the contract. The current FAR clause measures compliance through a complicated calculation of the cost incurred for personnel for services, or the cost of manufacturing for supplies. Under the proposed rule, as in the SBA’s current regulations, the “fifty-percent calculation” will simply be based on the percentage of contract revenues spent on subcontractors. The rule would likewise conform to the SBA’s regulations by permitting prime contractors to count subcontracts issued to “similarly situated” entities (small, 8(a), women-owned, veteran-owned, Historically Underutilized Business (HUBZone), etc.) towards meeting the fifty-percent requirement.

Changes to Veterans’ Preference Programs

Veteran-owned and service-disabled veteran-owned small businesses (VOSB/SDVOSB) have long chaffed under the competing demands of the Department of Veterans Affairs (VA) and the SBA’s differing set-aside rules. In the FY2017 NDAA, Congress placed responsibility for the ownership and control eligibility requirements squarely under SBA. Accordingly, on September 24, 2018, the VA issued a final rule relating to its VOSB/SDVOSB Veterans’ First Verification Program, by incorporating by reference the SBA’s regulations governing ownership and control of VOSBs. For now, the VA will still be responsible for managing the VOSB/SDVOSB verification process, but contractors will be able to appeal the VA’s eligibility determinations to the SBA.

In parallel, the SBA issued a corresponding final rule to implement the FY2017 NDAA’s mandate to bring more clarity and uniformity to the VOSB/SDVOSB eligibility requirements. Notably, SBA adopted many of the VA’s prior rules, particularly where SBA’s rules were considered “draconian,” and where the SBA’s rules differed from other SBA small business contracting programs. Most importantly, the final rule relaxes the SBA's prior "unconditional ownership" requirement, which SBA interpreted to mean that any restrictions on the veteran-owner by other company stakeholders rendered the company ineligible, no matter how customary. The new rules instead allow "extraordinary actions" for which non-veteran stakeholders (investors, other directors, etc.) may have input. By including a list of commercially routine minority investor rights as exceptions to the unconditional ownership requirement, the new rules should enable VOSB and SDVOSB concerns to more easily attract capital and other forms of assistance.

There is, however, some concern about unintended consequences from the SBA's new rules. The final rule makes changes to the day-to-day management requirements for the veteran-owner to demonstrate control. For example, the veteran is presumed to lack control if he or she does not work at the company during normal business hours, or if he or she is not located within a reasonable commute to headquarters or job site locations. Although these presumptions are rebuttable, they are inconsistent with the way many businesses operate, and may unfairly penalize disabled veterans who, for example, rely on remote work technology to manage their company.

Proposed Changes to the HUBZone Program

As testimony from multiple Congressional hearings and GAO reports confirms, the SBA's HUBZone program is one its most complicated, for both the agency and contractors. The purpose of the program is to bring economic benefits to underutilized areas of the country, but that purpose is often stymied by ambiguous and administratively burdensome regulations. Accordingly, in October 2018, the SBA issued proposed rules that will reduce the regulatory burdens on HUBZone firms, implement new statutory requirements, and eliminate ambiguities that have long frustrated HUBZone firms' compliance efforts and SBA's oversight. The proposed rule is intended to be a complete overhaul of the HUBZone rules, to make it easier for small business concerns to understand and comply with the program's requirements, and to make the HUBZone program more attractive for procuring agencies to utilize.

The proposed rule would change compliance timing for HUBZone firms. Under the current rules, a HUBZone firm must demonstrate that it meets the HUBZone requirements both at the time of offer and award, and must undergo certification every three years. The proposed rule would require a new annual certifications, but eliminate the burdensome requirement for a HUBZone firm to also demonstrate compliance at the time of offer and award.

Many of the proposed changes involve the current requirement that thirty-five percent of the firm's employees live in a HUBZone after award. The current rule requires HUBZone firms to "attempt to maintain" thirty-five percent of their employees as HUBZone residents during performance. Recognizing the difficulty HUBZone firms have with this specific requirement (and in light of the change to an annual certification process), the proposed rule would lower the "attempt to maintain" threshold to twenty percent, but still require good faith efforts to meet the thirty-five percent requirement.

The rule would also allow for situations where an employee can continue to be be counted as a HUBZone resident even if the area where the individual lives no longer qualifies as a HUBZone. It would also allow the firm to continue to count an individual who has moved to a non-HUBZone area, as long as that individual worked for the firm (and continues to work for the same firm) and resided in a HUBZone at the time the concern was certified or recertified as a HUBZone small business concern.

The rule would also eliminate other ambiguities in the regulations, which the SBA found to result in frequent inquiries. The rule, for example, clarifies that all employees count when determining the concern's "principal office," and not just the subset of HUBZone resident employees.

For further information regarding these changes or other small business issues, please contact one of the authors listed on this article.