

ALERT

Federal Circuit Says Intervene in NAICS Code Appeals or Forever Hold Your Peace

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Contractors considering small business set-aside opportunities need to be on the look-out for North American Industry Classification System (NAICS) code appeals, as it is now clear there will only be one bite at the apple for these challenges. In a recent decision, *Palladian Partners, Inc. v. United States*, the U.S. Court of Appeals for the Federal Circuit (Federal Circuit) affirmed that the Court of Federal Claims (COFC) has jurisdiction under the Tucker Act over NAICS code appeals decisions issued by the Small Business Administration's (SBA) Office of Hearings and Appeals (OHA). In reversing an earlier COFC decision, the Federal Circuit held that contractors must exhaust their administrative remedies before bringing a COFC action challenging a NAICS code designation by either (1) bringing their own NAICS appeal at OHA, or (2) intervening in the NAICS appeal of another contractor. If they fail to take one of those actions, contractors are precluded from subsequently challenging the NAICS code designation in court.

Palladian Partners involved a small-business set-aside solicitation to fund a Coordination Center for Centers of Excellence in Pain Education run by the National Institute of Drug Abuse (NIDA), a division of the National Institutes of Health (NIH). Set-aside solicitations are required to identify a NAICS code that defines the size limits of eligible small business offerors; some codes have a limit on employees and some a limit on average annual revenues. Contracting Officers are required to select the NAICS code that best describes the nature of the work to be performed under the contract.

Information Ventures, Inc., an interested small business vendor, filed a NAICS code appeal at OHA challenging the NAICS code designated for the procurement. Pursuant to SBA's regulations governing NAICS

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code appeals, OHA instructed the Contracting Officer to amend the solicitation to provide notice of the appeal to all potential offerors (which included Palladian Partners, Inc. (Palladian)). No potential offerors intervened in the appeal. OHA ultimately disagreed with the Contracting Officer's NAICS code designation and issued a decision mandating that the NAICS code be changed to a code OHA determined to be a better match to the solicitation's primary purpose.

Consistent with OHA's decision, the Contracting Officer amended the solicitation to include the new NAICS code. While the original code had an employee headcount limit, the new code set an annual revenue limit, which had the effect of excluding Palladian from the competition. Palladian appealed the new NAICS code to OHA. OHA dismissed the appeal on the grounds that SBA's regulations precluded OHA from reconsidering its prior NAICS code decision for that procurement. Palladian simultaneously filed a pre-award bid protest at the COFC arguing that the Contracting Officer's designation of the new NAICS code (based on OHA's decision) was arbitrary and capricious. The COFC agreed, finding that a third NAICS code actually best described the work, and the United States appealed.

On appeal, the Federal Circuit first held that the COFC correctly determined that it had jurisdiction under the Tucker Act because OHA's NAICS code determination and the subsequent amendment to the solicitation were actions "in connection with a proposed procurement." 28 U.S.C. § 1491(b)(1). But the Federal Circuit agreed with the Government that SBA's regulations specifically require contractors to exhaust their administrative remedies before seeking judicial review. The Federal Circuit further held that because OHA NAICS code appeals are final and not subject to reconsideration under SBA's regulations, interested parties must intervene in a pending NAICS code proceeding to preserve their rights to judicial review. Because Palladian failed to intervene in Information Ventures' original NAICS code appeal, it failed to exhaust its administrative remedies.

The Federal Circuit also concluded that these circumstances did not meet any exception to the exhaustion requirement. The COFC had determined that requiring intervention met the futility exception to the exhaustion requirement: small businesses would be required to file "useless motions in order to preserve their rights." The COFC expressed concern that small business would "be forced to expend significant time and money to involve themselves in potentially costly litigation" that may ultimately be unnecessary. The Federal Circuit rejected that conclusion, stating that the futility exception is narrow and that contractors can intervene simply by "filing a letter with OHA," thus preserving their right to judicial review. Palladian also tried to assert that it was excused from intervening because its present argument for a different code had already been before the agency in the original appeal: OHA was required to consider a broader set of codes than it had. The Federal Circuit concluded that such reasoning would result in "endless cycles of NAICS code litigation." The COFC decision was thus reversed and the NAICS code change upheld.

This decision is a warning to small business contractors and their large business partners to consider intervention in a NAICS code appeal when they receive notice from the Contracting Officer. As Palladian discovered here, failure to intervene could bar a contractor from the competition without any judicial remedy.