



GLOBAL CONSTRUCTION

STEPHEN KELLEHER

Attorney
Smith Currie & Hancock
202.452.2140
sjkelleher@smithcurrie.com

navigant.com

About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the Firm primarily serves clients in the healthcare, energy and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at navigant.com.

SMALL BUSINESS ADMINISTRATION (SBA) PUBLISHES FINAL RULE IMPLEMENTING THE NATIONAL DEFENSE AUTHORIZATION ACT OF 2013

On May 31, 2016, the Small Business Administration (SBA) published a final rule amending its regulations implementing the National Defense Authorization Act (NDAA) of 2013. The full rule can be found in the Federal Register at 81 Fed. Reg. 32,451. The new rule became effective on June 30, 2016. For construction contractors, the major changes covered by the final rule include significant modifications to the rules for Limitations on Subcontracting, revisions to the rules regarding affiliation, joint ventures and size protests, and small, but important, revisions to the rules regarding small business subcontracting plans.

The final rule implements important changes to the Limitation on Subcontracting provisions that will have immediate impact on small business construction contractors. On construction contracts, the new Limitation on Subcontracting provisions restrict a small business prime contractor from subcontracting more than 85% of the "amount paid by the government to firms that are not similarly situated" and states that the cost of materials are excluded from the calculation. 13 C.F.R. §125.6(a)(3).¹ A similarly situated entity is defined as "a subcontractor that has the same small business program status as the prime contractor." 13 C.F.R. §125.1. As the SBA explains, if a contract is set-aside for HUBZone contractors, then all subcontractors that are also HUBZone small business concerns will be "similarly situated," provided that the subcontractor also is small under the NAICS code that the prime contractor assigns to the subcontract. The manner in which the SBA has defined "similarly situated" seems to favor contractors that qualify for a small business set-aside rather than a set-aside for one of the other SBA small business programs. That is, small business contractors will likely have a far greater pool of potential small business subcontractors than a HUBZone or Service Disabled Veteran Owned Subcontractor would have.

1. The new rule is similar to the existing rule that required small business prime contractors to perform at least 15% of the cost of the contracting with its own employees, excluding the cost of materials.

Though the rule will be beneficial to small business prime contractors, in that there will be additional ways to ensure the limitation on subcontracting will not be exceeded, there are risks and pitfalls of which the prime contractor must be aware. First, the rule specifically states that any work further subcontracted by the similarly situated subcontractor is not counted in the limitations calculations. If, for example, a similarly situated subcontractor is given a \$500,000 subcontract by the small business prime, but the subcontractor will only perform \$100,000 of the work, only \$100,000 will count toward the limitation calculation. The prime contractor needs to be sure to account only for the amount that its first tier similarly situated subcontractors will actually perform to be able to calculate what the prime contractor needs to perform to satisfy the rule. Second, if a small business prime plans on using a similarly situated subcontractor late in the project, there is a risk that the similarly situated subcontractor is no longer available. Similarly, as with all subcontracts, there is a risk of default. If a similarly situated subcontractor defaults and must be replaced, it may be difficult to find a replacement subcontractor on relatively short notice and with the consent of a surety, if any are involved in the default. Third, the small business prime contractor must rely upon statements made by the subcontractor that it is similarly situated. The rule does not provide any guidance or information as to what extent a prime contractor may rely upon the representations made by its similarly situated subcontractors. Fourth, a late modification adding (or subtracting) significant portions of work may make it difficult for the prime contractor to satisfy the rule if the modification impacts either the work to be performed by the prime contractor or a similarly situated subcontractor.

In the proposed rule, the SBA required written agreements between the prime contractors and any similarly situated entities to be submitted prior to the receipt of an award, and those agreements were to set forth the percentage of work the similarly situated subcontractor would perform. After reviewing comments to the rule, the SBA acknowledged that this requirement would be overly burdensome for small businesses and would restrict their ability to change a subcontractor post-award. As a result, the SBA eliminated the requirement.

In another change from the proposed rule, the SBA eliminated a requirement that small business prime contractors report to the SBA on their compliance with the limitation on subcontracting provisions. The SBA did note, however, that it may issue a separate, new rule requiring mandatory reporting from all small businesses on subcontracting and compliance with the limitations on subcontracting requirements.

The final rule provides the SBA with the ability to use a contractor's failure to abide in accordance with "the spirit and intent" of the subcontracting limitations discussed above as a reason for debarment. See 13 C.F.R. §125.6(h). Despite this addition, the SBA decided that prime contractors do not need to certify compliance with the subcontracting limitations when subcontracting to "similarly situated entities." The final rule also includes a penalty provision specifying a fine of the "amount spent [by the company], in excess of permitted dollars," but no less than \$500,000.

The final rule also creates an exception to the ostensible subcontractor rule for a prime contractor and its similarly situated subcontractor. Under the SBA's affiliation rules, a small business prime contractor and its ostensible subcontractor were deemed to be in a joint venture, and as a result, affiliated. An ostensible subcontractor is one that performs the primary and vital requirements of a contract or a subcontract upon which the prime contractor is unusually reliant. The new exception will permit a small business prime contractor to avoid the risk of affiliation with a subcontractor if that subcontractor is similarly situated, even if the subcontractor performs the primary and vital requirements of the contract or the prime contractor is otherwise unduly reliant upon the subcontractor.

The new regulation indicates that the Government will note on a past performance evaluation the contractor's failure to make a good faith effort to follow its small business subcontracting plan or provide a corrective action plan "after receiving a marginal or unsatisfactory rating for its subcontracting plan performance,"² and will report the contractor's information to the SBA's Area Director. The new rule also mandates that prime contractors

2. Subcontracting Plans, 81 Fed. Reg. 32,451 (May 31, 2016) (to be codified at 13 C.F.R. pt.125).

inform small businesses when they have been selected for a potential subcontract, prior to using the subcontractor's name in a proposal, offer or subcontracting plan to be submitted to the Government. The notice must be provided in writing to each potential subcontractor. The new rule also permits subcontractors to report possible incidents of fraud or bad faith behavior by a prime or subcontractor, in relation to subcontracting plans.

Section §121.103(f) now clarifies what specific connections between parties will result in the presumption of an affiliation. The connections listed include the familial ties of marriage and civil unions, parents, children and siblings, with the added element of transactions between the business entities they own. Alternatively, when at least 70% of a company's revenues over the previous three fiscal years come from another entity, the SBA will presume a connection on the basis of economic dependence. Regulations state that the presumption of affiliation is rebuttable by documentation of independence between the parties.

The new rule also allows for more opportunities for small businesses to joint venture and avoid a finding of affiliation based on those joint ventures. The new language allows for a joint venture exception for two or more companies if they are both small businesses, as long as neither is above the size standard for the NAICS code of the award. Previously, joint ventures were allowed teams of one mentor and one protégé under the SBA's Mentor-Protégé Program, "bundled or consolidated requirement[s]"³ of any amount, other procurements with a receipts based size standard where the amount (with options) exceeds half of the size standard for the NAICS code of award or an employee-based size standard where the amount exceeds \$10 million (with options).



The SBA indicates that parties may only file a size protest when they are in consideration or selected for award. There is no standing for contractors eliminated due to "non-responsiveness, technical unacceptability or [being] outside of the competitive range."⁴ This change codifies decisions by the SBA Office of Hearings and Appeals⁵ and clarifies the wording of the regulations.

Contractors with questions on how these regulations impact their business and how to develop sound strategies to comply with these requirements should contact Steven L. Reed at sreed@smithcurrie.com or Stephen Kelleher at sjkelleher@smithcurrie.com.

3. 13 C.F.R. §121.103(h)(3)

4. 13 C.F.R. §121.1001

5. Size Appeal of: Bosco Constructors, Inc., Appellant Re: Roundhouse Pbn, SBA No. SIZ-5345 (Apr. 27, 2012)