



# Doing Business with Small Businesses in the Federal Marketplace

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# Steve Tibbets



Steve Tibbets, Senior Counsel with the software company CA Technologies, is a government contracts and technology lawyer with about 10 years of experience working with companies of all sizes in a variety of industries, including aerospace and defense, IT, and health care. In his current role, he focuses on transactions and regulatory compliance involving software licensing and IT services and public sector customers. Specifically, Steve supports CA's public sector sales business by reviewing and negotiating the terms of public sector sales transactions and advising business leaders on legal compliance and business strategy matters. Prior to joining CA in 2014, he worked for several law firms and focused on, among other things, litigating government contracts cases, advising government contractors and grant recipients on compliance with government regulations, and handling both internal and government investigations.

# Devon E. Hewitt



**Devon Hewitt**, a partner at Protorae Law PLLC, has over 20 years' experience in the field of government contracts, representing small, mid-tier and large government contractors. She advises clients on a wide range of government contracting issues including FAR compliance; small business contracting programs; intellectual property and data rights; GSA Schedule; the Service Contract Act; noncompete, nonsolicitation and nondisclosure agreements; subcontracts and teaming arrangements; joint ventures; FOIA; due diligence and novations; contract claims; codes of ethics and business conduct; mandatory and voluntary disclosures; suspension and debarment; terminations; and government audits and investigations.

Ms. Hewitt also is a litigator and has represented clients in nearly 100 protests before federal agencies, the U.S. Court of Federal Claims, and the Government Accountability Office. She is one of the few attorneys that has argued bid protest appeals before the United States Court of Appeals for the Federal Circuit. In addition, Ms. Hewitt represents clients in subcontract and other dispute matters in civil courts and in arbitrations. Prior to joining Protorae Law, Ms. Hewitt was a partner at Piliero Mazza in DC and a partner in the Government Contracts practice of Pillsbury, a large, multi-national law firm.

# Background Concepts

- Federal Contracting and Small Business Resources:
  - <https://www.sba.gov/contracting> – U.S. Small Business Administration's in-depth guidance regarding 'how, what, where, when, and why' for small businesses and federal contracting
  - <https://gsaforecast.gsa.gov/> - U.S. General Services Administration database of contract opportunities relevant to small businesses
  - <http://www.sam.gov> – U.S. Government System for Award Management which contains federal contractors' representations and certifications, including size status and whether contractors fall within any disadvantaged business categories

# Background Concepts – Contracting Generally

- FAR Part 19: Contracting officers must observe certain preferences for small businesses, as well as more specific preferences for small businesses whose owners fall within certain historically disadvantaged categories (women, racial minorities, etc.)
- Broadly speaking – very broadly – federal procurements must be set aside for small businesses unless some exception applies
- Main Exceptions:
  - It's unlikely that at least two small businesses can compete for the prime contract (“Rule of Two”)
  - The proposed acquisition is for a large bundle of supplies and/or services it is unlikely a small business could fulfill

# Background Concepts – Size Standards and Determinations

- SBA promulgates size standards that differentiate between small and large businesses based on average annual receipts or employee headcount
- Each North American Industry Classification System, or “NAICS,” code has a specific size standard – the table including all of these appears at 13 C.F.R. 121.201
- Two common size standards cover many industries:
  - A small business for most manufacturing and mining industries is defined as having 500 or fewer employees.
  - A small business for most nonmanufacturing industries is one that does not exceed \$7.5 million in average annual receipts.
- Contractors make representations about their size statuses and contracting officers are supposed to confirm their size statuses for any procurements where it's relevant
- If there are disagreements, SBA may perform size determinations, which may be initiated by contractors themselves, government personnel, or competitors (via size protests)

## Background Concepts - Affiliation

- When two or more companies have certain types of connections, they are “affiliated” and their headcounts or receipts are combined for purposes of determining size
- Affiliation prevents large businesses from “stealing” the benefits of small business programs by, for example, maintaining a small subsidiary or maintaining a family of commonly-owned companies that remain *just* under the applicable size standard
- Generally, affiliation exists:
  - When one or more individuals or businesses controls or has the power to control another or
  - When a third party controls or has the power to control both businesses. Control may arise through ownership, management, or other relationships or interactions between the parties.
- Control may be affirmative or negative
  - Negative control includes instances where a minority shareholder has the ability, under the firm's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.
  - SBA regulations - 13 CFR 121.103 - provide detailed examples of relationships and ownership structures that give rise to affiliation

## Background Concepts - Affiliation

- The “Ostensible Subcontractor” Rule
  - A prime and sub may be affiliated where
    - The small business prime “is unusually reliant” on a subcontractor; or
    - A large subcontractor “performs primary and vital requirements of a contract”
  - Often arises in connection with teaming agreement and is based on all aspects of the relationship between the prime and subcontractor
  - Application of this standard is somewhat subjective, and factors SBA has considered in the past include:
    - The overall division of work between prime and sub
    - Whether, and how many, key management personnel working on a contract are supplied by the large sub
    - The relative experience of the prime and sub
    - Teaming agreement terms
    - Incumbency - if a large incumbent suddenly becomes a subcontractor, it seems likely that “business as usual will continue
    - Proposal preparation
    - Whether proposal refers to what “team” will deliver significantly more than what small prime itself will deliver



# Background Concepts – Nonmanufacturer Rule

- The Nonmanufacturer rule allows a small business to offer a product that it did not manufacture under a small business set-aside if SBA has offered a waiver – a small business set-aside contract where the prime just subcontracts the whole thing to a large business does not really accomplish the policy goal of promoting small businesses
- On a supply contract, a firm must perform processes that account for at least 50% of the cost of manufacturing the supplies (not including the cost of materials)
- The NMR is an *exception* to the performance requirements, and provides that a firm that is *not* a manufacturer may qualify as a small business on a supply contract set aside for small business if, among other things, it supplies the product of a small business made in the United States
- SBA often issues nonmanufacturer waivers for entire classes of products that small business generally cannot manufacture on an economically feasible basis – that list appears here: <https://www.sba.gov/contracting/contracting-officials/non-manufacturer-rule/class-waivers>

## Background Concepts - Subcontracting Plans

- Small Business Subcontracting Plans
  - A Small Business Subcontracting Plan is required:
    - From large businesses, when work is performed in U.S., not personal services
    - Contracts or mods >\$650,000 (\$1.5M for construction) *if* they offer opportunities to subcontract
  - Must be approved before award - Includes small business goals and designated Small Business Liaison Officer (SBLO)

# Large Business Prime/Small Business Sub

- Recent Developments
  - Relying on Subcontractor Certifications
  - Small business sub entitled to work if mentioned in proposal/teaming agreement
  - Reporting of delayed/nonpayment to small business subs
  
- Practical Challenges for In-House Counsel
  - Investment in employees versus subcontractors

# Large Business Prime/Small Business Sub

- Recent Developments – Relying on Small Subs' Certifications
  - A rule SBA promulgated in 2013, 78 Fed. Reg. 38811-21, prescribes harsh penalties for small businesses that willfully misrepresent their small business size status for the purpose of soliciting or obtaining a federal government contract or other federal funding, will face additional harsh penalties
  - Penalties include: suspension or debarment, liability under civil and criminal false claims statutes, and repayment to the government
  - The good news: a prime contractor generally isn't liable for a small subcontractor's written representations about its size
    - Prime contractors, however, will only be insulated from liability if they acted "in good faith," and took reasonable steps to protect against misrepresentations
    - Some practitioners have suggested prime contractors should require their vendors and suppliers to annually submit written certifications regarding their small business size status and update such certifications if and when their size status changes to establish a record that the prime has relied on subcontractor representations in good faith

## Large Business Prime/Small Business Sub

- Proposed Rule
  - SBA issued a significant proposed rule at the end of 2014, 79 Fed. Reg. 77955-70 (Dec. 29, 2014) (“Proposed Rule”) implementing provisions of the NDAA for FY2013
  - Comment period closed April 6, 2015
  - Exactly when changes will go into effect is unclear, but comments on proposed rule do not indicate significant resistance from industry or other stakeholders

# Large Business Prime/Small Business Sub

- Recent Developments – Small Subs' Entitlement to Work
  - Proposed Rule: “A prime contractor that identifies a small business by name as a subcontractor in a proposal, offer, bid or subcontracting plan must notify those subcontractors in writing prior to identifying the concern in the proposal, bid, offer, or subcontracting plan.”
  - While a similar protection can be built into teaming agreements, this FAR language would obligate primes to keep their prospective subs informed as to how much value mentioning them is adding to a prime's proposal
  - The lesson for large businesses is that – if the Proposed Rule becomes final – they *really* should not mention potential small business subcontractors in their proposals unless they intend to work with those subcontractors (which is not a new principle to follow; the Proposed Rule just raises the stakes for large primes)

# Large Business Prime/Small Business Sub

- Recent Developments (from late 2013) – Reporting of Delayed Payment, or Nonpayment, to Small Subs
  - FAR 52.232-40 – when a prime contractor receives an accelerated payment from the government, it must make an accelerated payment to its small business subcontractors (as long as they've submitted invoices and supporting documentation)
    - Supersedes any contrary terms in subcontracts
    - Failure to make an accelerated payment means the government may stop making accelerated payments to the prime
  - 13 CFR 125.3 – SBA requires prime contractors to submit written reports of:
    - Any reduced payments to small business subcontractors
    - Any payments that are ninety (90) days or more past due
    - Deviations from the small business subcontracting plans that were submitted with their proposals
    - Explanations for why an originally proposed subcontractor was not used, whether it be due to post-award changes in the scope of work or any other business reason

# Large Business Prime/Small Business Sub

- Practical Challenge: Investing in employees versus subcontractors
  - Services contractors often find themselves using subcontractors because they lack immediate personnel resources
    - Balancing current payroll with future needs is tricky – as anyone here who has had a management role in a law firm can confirm
    - Using small firms with more flexibility can be a handy stop-gap
    - As projects progress, personnel often become entrenched and small subs have leverage to demand higher rates and encourage customers to make follow-on contracts small
  - One strategy: provide for periodic replacement of subcontractor staff with employees in subcontract document
    - Most often, subcontracts require the subcontractor to provide personnel of like qualifications and ability if one of their employees leaves
    - Consider a right of first refusal to replace with the prime's own employees – subcontractor would likely be relieved in the event of sudden departures
    - Plan overall procurement in a way that allows for such replacement without undermining small business subcontracting goals.



## Small Business Prime/Large Business Sub – Recent Developments and Practical Challenges

- Recent Developments – Proposed SBA Rule
  - Use of “commercial supply” NAICS code for certain software-related services – making them eligible for large business subcontracts
  - Limitations on subcontracting
  - Affiliation
  
- Practical Challenges for In-House Counsel
  - “Hot potato” handling of flow downs

## Small Business Prime/Large Business Sub

- Proposed Rule: Commercial Supply NAICS Codes
  - Addition of a footnote to NAICS Code 511210, Software Publishers
    - Footnote will direct that this NAICS code should be used when the Government is publishing computer software that is eligible for a waiver of the nonmanufacturer rule
      - Buys of purely commercial unmodified software **are eligible**
      - Software customization and design services, most cloud and 'SaaS' offerings **are not eligible**
      - 'Mostly-software' buys that include some services, like installation and support, **are eligible** provided the value of services are not greater than the value of supplies
    - A practical challenge for large software companies will be communicating – and helping their small business primes communicate – to agencies about why their offerings are waiver eligible

## Small Business Prime/Large Business Sub

- Proposed Rule: Limitations on Subcontracting
  - Empowering Procurement Center Representatives to:
    - Advocate against consolidation or bundling of requirements; and
    - Accept unsolicited proposals from small businesses and present them to agencies
  - New term “limitations on subcontracting” replaces “performance of work” when referring to small businesses’ share of a contract
    - Small business prime contractors are limited in their ability to subcontract with firms that are other than small (or don’t meet the disadvantaged business criteria of the prime)

# Small Business Prime/Large Business Sub

- Proposed Rule: Limitations on Subcontracting
  - Limitation on subcontracting with large businesses for services and supplies is statutorily set at 50% of the award amount received by the prime contractor
    - “In SBA’s view, a large business that that ultimately performs 90% of a small business set-aside contract unduly benefits from a contract intended to be performed by small business”
  - *However*, small business set-aside contracts between \$3,000 and \$150,000 would be exempt from this limitation
    - The rationale is that many transactions at this level will involve commercial items – particularly “brand name” commercial items – that small businesses don’t generally manufacture
    - Note – this would only apply to size-based set-asides; it would not apply to procurements set-aside for disadvantaged business categories

# Small Business Prime/Large Business Sub

- Proposed Rule: Affiliation
  - The Proposed Rule establishes a rebuttable presumption that firms owned by persons with family ties are affiliated – for these purposes, family ties include *only*:
    - Married couples
    - Parties to a civil union
    - Parents and children
    - Siblings
  - This presumption may be overcome by evidence showing a “clear line of fracture” between two businesses
  - This change basically codifies SBA OHA size determination case law

# Small Business Prime/Large Business Sub

- Practical Challenge: “Hot Potato” handling of flow downs
  - A constant challenge is trying to get small primes to do the work of eliminating unnecessary flow downs rather than simply slapping an entire government RFP or Statement of Work into a subcontract
  - One strategy: for “repeat player” small primes, develop a set of oft-flowed down provisions you agree to and refuse to accept any other flow downs unless the prime establishes that they are mandatory
  - Another strategy: inform regarding the *real* risk for both parties over terms relating to unlimited liability, indemnification, etc. – if something goes so wrong that terms like these matter, the small prime will have the luxury of bankruptcy if it does not flow down
  - Yet another strategy: coach the prime on how to negotiate with the customer. For example, principles embedded in the FAR that commercial items should be procured on commercial terms to convince government contracting officer that he or she is not actually required to

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# Joint Ventures

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## What is a joint venture?

- A form of “teaming” under FAR 9.601
- Business arrangement whereby the parties agree to develop, for a finite time, a new entity and create new assets by contributing equity
- Key characteristics:
  - A separate legal entity (generally a partnership or LLC)
  - Includes “members” with proportionate interests in the entity
  - Limited in duration
  - Special purpose
  - Sharing of profits and losses among members



## What is a SBA Joint Venture?

- A joint venture looking to compete in small business set-aside competitions must meet SBA's definition/rules for joint ventures
- SBA defines the term joint venture as an "association of concerns or individuals" that combine their "efforts, property, money, skill or knowledge" but NOT on a continuing basis for "conducting business generally" (13 CFR 121.103(h))
- The joint venture must have the limited purpose of receiving three (3) contracts in two (2) years (known as the 3 in 2 rule) (13 CFR 121.103(h))
  - 2 year time period begins with first contract award
  - JV can be awarded more than 3 contracts if several proposals submitted after second award but before expiration of 2 year period
  - Parties to the JV can form another, new joint venture after receiving three contract awards

## Affiliation

- SBA regulations provide that joint venture members are affiliated for size purposes (13 CFR 121.103(h)(2))
  - Once two businesses are determined to be “affiliated”, SBA will aggregate the size of both companies to determine whether the joint venture is “small” for a small business set-aside
- “Small” refers to size standard associated with NAICS code applicable to the procurement
- If aggregated size of joint venture members greater than size standard, joint venture not eligible to compete for set aside
- Two exceptions to this affiliation rule for joint ventures (see 13 CFR 121.103(h)(3))

## Exception 1

- Where all members of the joint venture are “small” under the applicable size standard and
  - The procurement is “bundled” or
  - If the size standard is stated in revenues, the value of the procurement is greater than  $\frac{1}{2}$  the size standard or
  - If the size standard is stated in employees, the value of the procurement exceeds \$10 million
  - 13 CFR 121.103(h)(3)(i).

## Exception 1 - Example

The procurement value is:

- More than ½ the applicable size standard for revenue-based size standards

### EXAMPLE: SMALL BUSINESS SET-ASIDE

<b>NAICS SB Size Standard</b>	\$20M
<b>Solicitation Value</b>	\$16M
<b>JV of 3 SB Contractors: Annual Revenues</b>	Contractor A: \$7M Contractor B: \$10M Contractor C: \$5M
<b>Total Aggregated Revenue of JV</b>	\$23M

- Aggregated contractor annual revenue (\$23M) exceeds the applicable NAICS small business size standard (\$20M), which would normally disqualify the team for this small business set-aside opportunity
- However, the procurement value (\$16M) is more than ½ the applicable NAICS small business size standard (\$20M) – this affiliation exception allows the team to pursue this opportunity

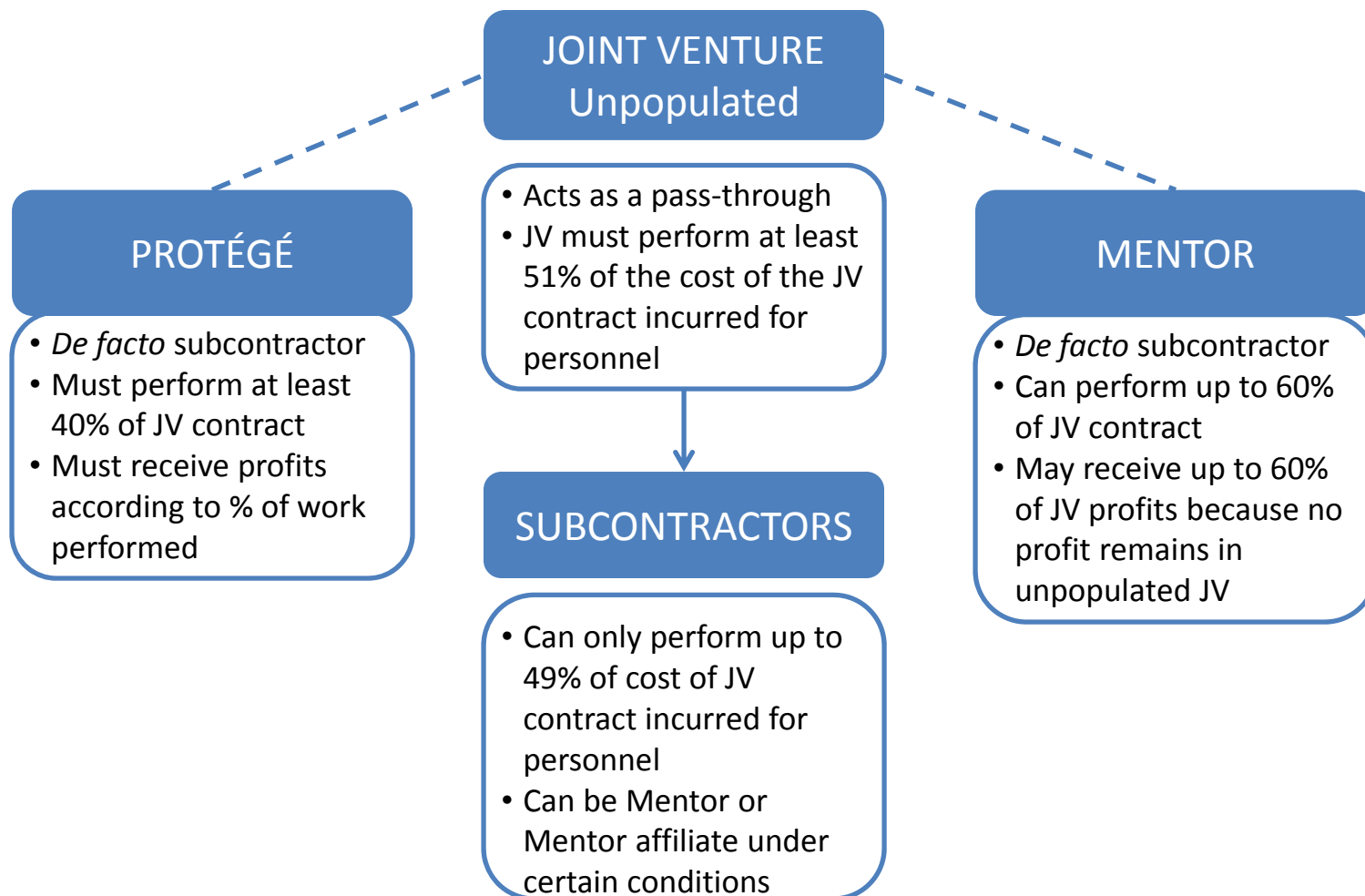
## Exception 2

- Mentor-Protégé Joint Venture  
(13 CFR 121.103(h)(3)(iii))
    - Mentor-Protégé Program is part of SBA's 8(a) Program\*
    - Mentor-Protégé relationship is between an 8(a) Program Participant and, typically, a large business
    - Mentor-Protégé document must be executed and approved by SBA before parties can create a joint venture and submit a bid/proposal as a joint venture w/o concern for application of affiliation rule
- \*Proposed Rule pending which will authorize similar M/P Program for all small businesses!**

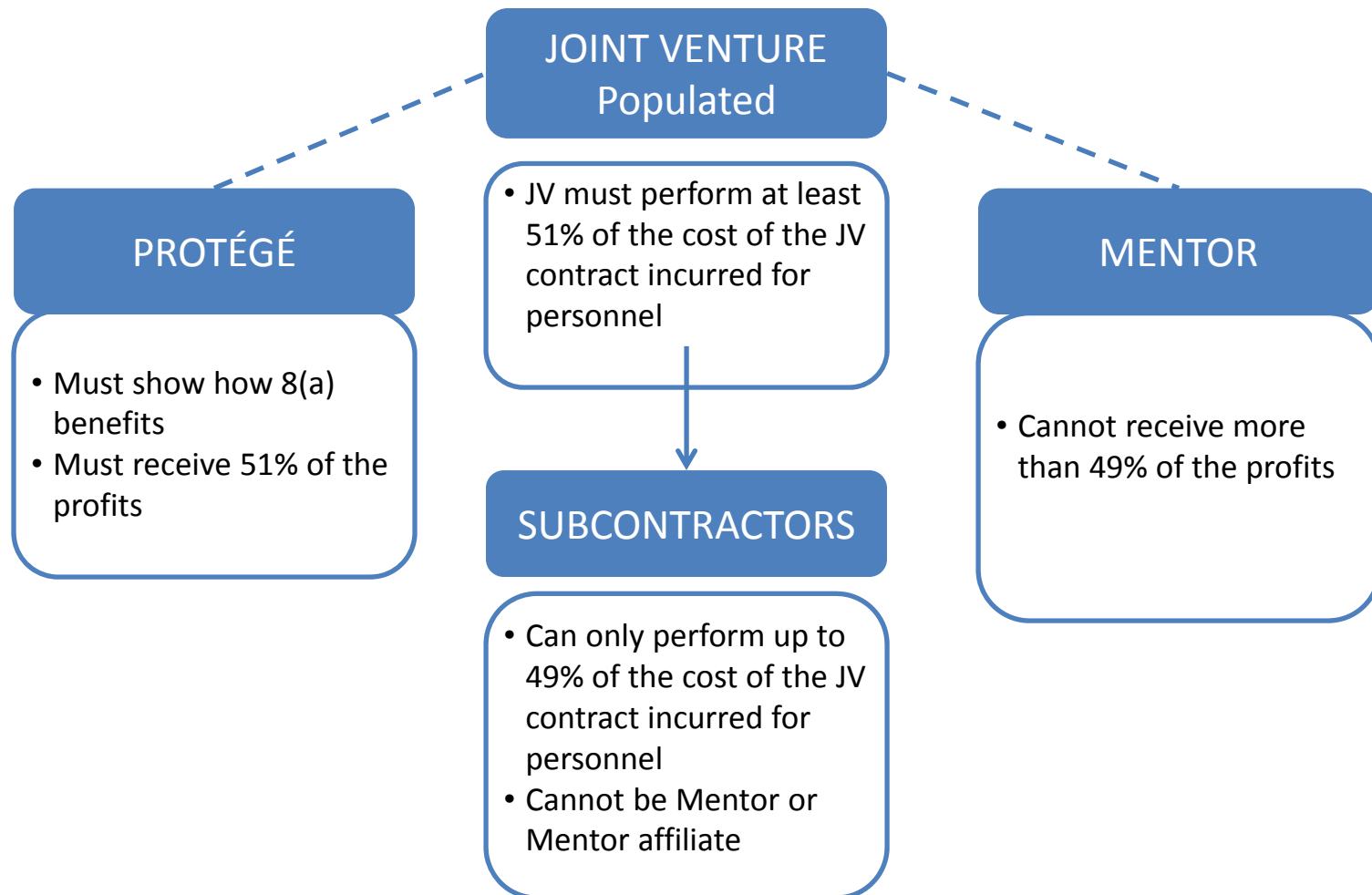
## Mentor-Protégé Joint Venture (cont.)

- M/P joint ventures can be “populated” or “unpopulated”; most are “unpopulated”
- In unpopulated JV, 8(a) member must perform 40% of the work and other member may perform up to 60% of the work
- JV itself, through both members, must comply with the FAR Limitations on Subcontracting clause, 52.219-14
  - Together, the members must perform greater than 50% of the cost of the contract incurred for personnel (for services contract)

# Unpopulated SBA Mentor-Protégé Joint Venture



# Populated SBA Mentor-Protégé Joint Venture





# Joint Venture Requirements

## 13 CFR 124.513(c)

- Must be in writing
- Can be partnership or separate legal entity (LLC or corporation)
- 8(a) must be “managing venturer”
- Employee of 8(a) must be Project Manger and responsible for performance of the contract
- Bank Account must be established in name of joint venture
  - Signature of both members required for withdrawal of funds

## Joint Venture Requirements (cont.)

- All parties to the joint venture must ensure complete performance of 8(a) contract even if member withdraws
- 8(a) must physically keep accounting and administrative records
- Financial statements and reports must be submitted to SBA
- JV agreement must be approved by SBA before receiving an 8(a) contract; approval not necessary for other types of set-aside awards

## Joint Venture Advantages - Small Businesses

- Allows small business to chase more complex procurements and allows for one stop shopping by the government
- Allows small businesses to become a prime and receive prime contractor past performance
- Allows small businesses to be on “front line” with the client
- Allows small businesses to remain small longer

## M/P Joint Venture Advantages – Mentors

- Can access contract revenue reserved for “small” businesses and for which Mentor typically is ineligible to receive
- Can perform up to 60% of the contract work
- Mentor can also own up to 40% of the Protégé
- Allows Mentor to break into agency where Protégé has a niche
- Allows Mentor to have greater control over contract performance than if it was a sub

## Joint Venture Disadvantages

- Structure unfamiliar to government
- More paperwork, more expense
- M/P joint ventures have strict requirements which limit ability of Mentor to control actions of the joint venture
- Competition among members, difficult to speak with “one voice”
- Hard to exit – may be stuck with other member for contract term

## New Small Business M/P Program

- Small Business Jobs Act and National Defense Authorization Act for FY 2013 authorized a M/P program for *all* small businesses (not just 8(a)s)
- Proposed Rule issued Feb. 5, 2015, 80 Fed. Reg. 6618; Final Rule expected this summer

## New Small Business M/P Program (cont.)

- New small business M/P Program will be in addition to existing 8(a) M/P Program
- Applies to all small businesses other than 8(a) concerns
- SBA plans to verify small business status of companies in program (no self-certification)
- Planning on two separate tracks for M/P applications, but may be consolidated in one office

## New Small Business M/P Program (cont.)

- May institute “open” / “closed” application periods
- Mentor will be allowed to have three Protégés spread across the two programs
- Mentor may be able to own 40% equity interest in Protégé



## Other Agency M/P Programs

- Other agencies or departments (except DoD) cannot continue agency/department-specific Mentor-Protégé programs unless program plans are submitted to and approved by SBA
- Agency may operate existing Mentor-Protégé program for 1 year following SBA issuance of final rules for the small business Mentor-Protégé program
- SBA requested comments on whether there will be a continuing need for other agency Mentor-Protégé programs (such as the VA program)
- SBA requested comments on whether its small business Mentor-Protégé program should include subcontracting incentives authorized by other agency Mentor-Protégé programs

# Questions?

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