Government Contracts Update

July 2023

Top 10 Things Contractors Need To Know About SBA's New Rule on the 8(a) Program

Key Notes:

- SBA's Final Rule provides significant updates and clarifications to the regulations under the 8(a) Program and other SBA government contracting programs.
- Changes were also made to regulations governing small business joint ventures and to the rules on Limitations on Subcontracting and Ostensible Subcontractors.

On May 30, 2023, the U.S. Small Business Administration's (SBA) final rule entitled, "Ownership and Control and Contractual Assistance Requirements for the 8(a) Business Development Program" (Final Rule) went into effect, making substantial amendments and clarifications to regulations under its 8(a) Business Development Program (8(a) Program). And despite its title, the Final Rule also changes other SBA Programs, including the Women-Owned Small Business Program (WOSB Program), and it clarifies language impacting rules on joint ventures, qualifications for small businesses, and set-aside competition requirements. SBA packed quite a few changes and clarifications into the Final Rule, so we have distilled the top 10 things government contractors need to know.

1. Business Development Plans

Under 13 CFR § 124.402, 8(a), Participants must submit comprehensive business plans shortly after acceptance into the 8(a) Program. Failing to submit a business plan within 60 days of program admission will result in suspension from receiving 8(a) Program benefits. In the Final Rule, SBA addressed concerns raised about the business plan approval process. Many Participants with self-marketed procurement commitments before entering the 8(a) Program have missed contract opportunities because SBA did not approve their business plan before the procuring agencies made an award. To remedy this issue, the Final Rule more clearly states that SBA will prioritize business plan approval for any firm that is offered a sole source 8(a) contract or is the apparent successful offeror for a competitive 8(a) procurement. Importantly, if a Participant has yet to receive business plan approval but has been selected as the apparent successful offeror by the procuring agency, SBA will approve the Participant's business plan as part of its eligibility determination before contract award.

2. Business Activity Targets

The Final Rule provides some relief regarding the non-8(a) business activity target (BAT) requirements for 8(a) Program Participants. 13 CFR § 124.503(i)(1)(iv) provides that 8(a) Program Participants must meet the BAT under 13 CFR § 124.509 for SBA to approve a sole source 8(a) contracts awarded to a Participant. The only exception to meeting the BAT requirements is if the Participant can identify good faith efforts to meet those targets.

According to the Final Rule, good faith efforts can be demonstrated by showing proof of offer submissions for one or more non-8(a) procurements that would have given the Participant sufficient revenue to meet the business activity targets, if awarded. Alternatively, Participants can identify extenuating circumstances that have negatively impacted the Participant's efforts to secure non-8(a) revenue. While not exhaustive, the Final Rule identifies the following as examples of extenuating circumstances: a decrease in government funding, ongoing resolutions and budget uncertainties, increased competition driving prices down, or having one or more prime contractors award less work to the Participant than originally contemplated.

3. Bona Fide Place of Business Requirements

The Small Business Act, 15 U.S.C. 637(a)(11), mandates that 8(a) construction contracts "shall be awarded within the county or State where the work is to be performed," to the maximum extent practicable. To ensure that Participants adhere to this provision, SBA requires that the Participant have a "bona fide place of business" in the geographic location where the contract is to be performed. For purposes of this rule, a bona fide place of business means a location where a Participant regularly maintains an office that employs at least one full-time individual within the appropriate geographical boundary. The term does not include construction trailers or other temporary construction sites.

Small 8(a) construction contractors have long decried this rule as stifling growth, and SBA has engaged in numerous attempts to ease the impacts from this statutory mandate. Thus, the Final Rule adds that a Participant can now satisfy the bona fide place of business requirement by having a full-time employee operating an office in the specified geographic location. And critically, SBA clarifies that a home office is sufficient, and that the employee does not have to be a resident of the state where they conduct business. The employee also does not have to permanently reside in the location. As long as an individual, who does not necessarily have to be the same individual (i.e., a contractor may be able to rotate employees through the location), remains at the location, it will be considered a bona fide office. Notably, the bona fide place of business requirement has been suspended since 2021 due to the Covid-19 pandemic, but that moratorium expires on September 30, 2023.

4. Transfer of Ownership

Under 13 CFR § 124.515, if ownership of an 8(a) entity is transferred to another entity, the existing 8(a) contracts are terminated unless the SBA Administrator provides a waiver. Given that level of approval, the waiver request process is often lengthy, requiring submission in writing to the 8(a) Participant's SBA serving district office that articulates the grounds for the waiver. To streamline the process, SBA adopted new regulations providing that waiver requests can be submitted directly to the Associate Administrator, Office of Business Development (AA/BD) and must be processed within 90 days.

The Final Rule also deletes a sentence in the regulation providing that the acquiror of the 8(a) entity must have previously performed work similar to the work required under the existing contracts being transferred. SBA clarifies that the goal of the underlying statutory authority is to determine the current eligibility of the acquiror, not the entity's ability to perform under the contract in the future. That discretion rests with the procuring agency and thus, this restriction was removed from the regulation.

5. Graduation and Early Graduation Criteria

The criteria for an 8(a) Program Participant to graduate from the program are listed under 13 CFR § 124.302. Section 124.302(b) listed seven factors that SBA considered in determining whether a Participant qualified to graduate from the program. One of those factors included a comparison of the Participant's financial condition with the financial profile of non-8(a) Program businesses in the same or similar line of business.

SBA determined that some of the language in paragraph (b) was outdated and focused primarily on the financial state of a business when considering whether they should graduate from the program. SBA clarifies that the criterion for graduation is whether a Participant met the targets and objectives outlined in its business plan. Thus, the Final Rule removed paragraph (b) in its entirety.

6. Joint Venture Considerations

Two-year Restriction

Current SBA regulations state that the exception to affiliation between joint venture partners expires two years after the first contract award to the joint venture. SBA's policy has long been that the expiration of this two-year period should not affect contracts currently being performed. Thus, SBA clarifies in 13 CFR § 121.103(h) that this restriction only applies to new or "additional contracts, not continued performance on contracts already awarded" and as such, orders under previously awarded contracts are permissible beyond a two-year period.

Similarly, in 13 CFR § 121.513, SBA clarifies that sole source orders can be issued to 8(a) joint ventures under an 8(a) multiple award contract more than two years after the joint venture received its first award.

Non-Managing Partner Decisions

A frequent point of contention for non-managing joint venture partners is that their decision-making authority is expressly limited by SBA's regulations. SBA did not make significant changes to these requirements, in part because it deemed it "unnecessary" to articulate that non-managing partners can participate in decisions of the joint venture that are "commercially customary" as long as they adhere to SBA regulations. However, SBA did find it necessary to clarify that the approval or opinion of non-managing partners to decide what contract opportunities the joint venture should pursue and whether to initiate litigation on behalf of the joint venture is within the "bounds of customary commercial practices," and "may be required." Thus, joint venture agreements requiring non-managing partner input on those decisions will comply with SBA's regulations.

Populated/Unpopulated Joint Ventures

The current SBA regulations state that where a joint venture exists as a separate legal entity from its members, it may not be populated with people intended to perform small business and other set-aside contracts awarded to the joint venture. The Final Rule clarifies that an exception exists where all parties to the joint venture are "similarly situated entities" (i.e., they hold the same socioeconomic status and are "small" under the applicable size standard). However, SBA made clear that this does not provide an additional exception to affiliation. In determining size, SBA will aggregate the revenues or employees of each of the partners *and the joint venture* unless another exception to affiliation applies.

7. Ostensible Subcontractor Rule

The Final Rule explains the application of the ostensible subcontractor rule to general construction contracts and codifies the test for the rule promulgated by SBA's Office of Hearings and Appeals (OHA). Under the current regulation, an "ostensible subcontractor" is defined as a subcontractor that (1) is not a similarly situated entity and (2) performs primary and vital requirements of a contract, or upon which the prime contractor is "unusually reliant." As it relates to construction contracts, SBA clarifies that the role of the prime contractor in a general construction project is "to oversee and superintend, manage, and schedule the work, including coordinating the work of various subcontractors." Therefore, these are the "primary and vital requirements" of a general construction contract. In recognizing that subcontractors perform the bulk of the actual construction work, SBA clarified that such work does not fall within the "primary and vital requirements" of the contract.

SBA also incorporated a four-factor test for determining whether a small business prime contractor is overly reliant on a non-similarly situated subcontractor, and thus in violation of the rule. The test was adopted from the OHA decision in *DoverStaffing, Inc.*, SBA No. SIZ-5300 (2011). Under this rule, the following factors are considered: (1) the proposed subcontractor is the incumbent contractor and ineligible to compete for the procurement; (2) the prime contractor plans to hire the large majority of its workforce from the subcontractor; (3) the prime contractor's proposed management previously served with the subcontractor on the incumbent contract; and (4) the prime contractor lacks relevant experience and must rely upon its more experienced subcontractor to win the contract. The first two factors were already incorporated into SBA regulations, so the Final Rule merely acts to codify the third and fourth factors. However, SBA made sure to clarify that these factors will not be mechanically applied or weighed in a way that results in an incontestable determination that a prime contractor is running afoul of the ostensible subcontractor rule.

8. Limitations of Subcontracting Rule

The Final Rule makes two critical changes to the Limitations on Subcontracting rule, which prohibits prime contractors from paying more than 51% of the amount paid by the procuring agency under any set-aside contract to non-similarly situated subcontractors. The first change applies to multi-agency set-aside contracts such as government-wide acquisition vehicles and multi-agency IDIQs. The final rule clarifies that compliance with the limitations on subcontracting must be measured at the order level. Therefore, "the ordering agency must use the period of performance *for each order* to determine compliance" with the limitations on subcontracting.

The second change seeks to address concerns of widespread disregard for this rule by adding consequences for failure to comply with these requirements. If a procuring agency determines that a contractor failed to meet the limitation of subcontracting requirement at the end of the performance of a set-aside contract, the contracting officer may not give the contractor a past performance rating of satisfactory or higher for the appropriate evaluation factor or subfactor reported in the Contractor Performance Assessment Reporting System (CPARS). SBA did, however, provide a "safe harbor," requiring contracting officers to allow the contractor to identify "extenuating circumstances" (such as unforeseen labor shortages, emergency response requirements, and even the contractor's good faith reliance upon a subcontractor's representation of size or socioeconomic status) which can justify a higher performance rating.

9. Woman-Owned Small Business (WOSB) and Economically Disadvantaged Women-Owned Small Business (EDWOSB) Full-Time Devotion Rule

SBA revised the "full-time devotion" requirements for women or economically disadvantaged women claiming to control a WOSB or EDWOSB. 13 CFR § 127.202 provided that to qualify, the woman holding the highest position must manage the business on a full-time basis and devote full-time to its during normal working hours of a business in the same or similar line of business. To replace this "overly restrictive" requirement, the Final Rule states that even if the woman holds outside employment or otherwise does not work full-time at the business, this requirement is still satisfied as long as the outside employment does not prevent the woman from devoting sufficient time and attention to the business to control its management and daily operations. Accordingly, SBA will certify a business as a WOSB or EDWOSB if it is evident that a woman controls the business, even if her time commitment to the business is not within the normal working hours for like businesses. However, the Final Rule does include a rebuttable presumption of non-control where the woman devotes fewer hours to the business than its normal hours of operation.

10. Competition and Evaluation Preference Restrictions

SBA made two significant changes to how procuring agencies can restrict competition and create evaluation preferences in competitive procurements. First, SBA codified its long-held policy that procuring agencies cannot restrict competitions to require offerors to meet two or more socioeconomic programs. In other words, an agency may not include evaluation criteria which have the effect of creating a set-aside for firms certified in multiple SBA programs. Relatedly, the Final Rule states that procuring agencies may not give evaluation preferences to firms certified in multiple socioeconomic programs. Both policies could provide additional grounds for protests by disappointed contractors on competitions that run afoul of these mandates.

The Final Rule implemented many important and long-awaited changes to SBA's government contracting programs. And this wide-ranging rule impacted far more than is covered in the above, including changes to the HUBZone and Service-Disabled Veteran-Owned Small Business Programs. Thompson Hine's Government Contracts practice group is always happy to assist contractors with navigating the SBA's ever-changing regulatory landscape.

FOR MORE INFORMATION

For more information, please contact:

Edward T. DeLisle
202.973.2725
Edward.DeLisle@ThompsonHine.com

Andrés M. Vera
202.973.2795
Andres.Vera@ThompsonHine.com

Amaiya Johnson
(The George Washington University Law School, J.D. expected 2024) contributed significantly to this article. Amaiya is a Thompson Hine summer associate; she is not admitted to the practice of law. Please contact Liz Mrowiec to learn more about our summer program.