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Inside The NDAA's Small Business Provisions

Law360, New York (March 19, 2013, 1:06 PM ET) -- The enactment of the National Defense Authorization Act of 2013 on Jan. 2, 2013, will have several significant implications for small and other disadvantaged federal contractors. While primarily focused on the authorization of programs within the U.S. Department of Defense, the NDAA also contained several provisions which will have an impact on small business contracting and subcontracting programs, rules and procedures. A thorough understanding of these and other new regulations will enable small business contractors and subcontractors to fully capitalize on potential and existing contracting opportunities, and steer clear of potential pitfalls.

Potential Expansion of the SBA's Mentor-Protege Program — Section 1641

On its face, Section 1641 of the NDAA seeks to reaffirm the federal government's commitment to mentor-protege programs for small businesses. The NDAA authorizes (but does not require) the U.S. Small Business Administration administrator to expand the SBA's 8(a) Business Development mentor-protege program to similar programs for additional categories of small business concerns. New programs that may be established under the NDAA would be identical to the mentor-protege programs administered by the SBA for small business concerns under its 8(a) program.

The NDAA also puts the SBA in charge of mentor-protege programs operated by other federal agencies. Any new federal agency mentor-protege programs must be approved by the SBA, based on whether the proposed program assists proteges compete for federal contracting and subcontracting opportunities, and complies with SBA regulations governing mentor-protege programs. Pre-existing mentor-protege relationships under other agency programs will not be affected by these new regulations and will be allowed to continue operating until the expiration of their respective agreements. Also, mentoring programs under the Small Business Innovation Research and Small Business Technology Transfer programs are unaffected by this legislation. The SBA is required to propose regulations which include eligibility criteria, types and scope of developmental assistance for proteges, length of mentor-protege relationships, and reporting requirements no later than 270 days after the enactment of the NDAA.

Given that the SBA has yet to issue regulations authorized by the Jobs Act of 2012 with regard to mentor-protege programs for service-disabled veteran-owned small businesses, women-owned small businesses and HUBZone business, we cannot predict when the SBA will issue regulations for this expanded list of mentor-protege programs.

Limitations on Subcontracting — Section 1651

The NDAA makes important changes to the method of calculating the limitations on subcontracting activity under disadvantaged business set-aside contracts. Section 1651 changes the formula for calculating subcontracting limitations for both services and supplies contracts. For set-aside service contracts, a disadvantaged business prime contractor may

not subcontract more than 50 percent of the "amount paid" to the prime contractor under the contract. Previously, subcontracting limitations for service contracts were calculated as a percentage of the contract's cost of labor rather than the total contract costs. Similarly, under a set-aside contract for supplies, a disadvantaged business prime contractor may not expend more than 50 percent of the total "amount paid" the contractor (less the cost of materials of those supplies). Set-aside supply contracts used to deduct the cost of manufacturing from the total contract price prior to calculating the subcontract limitation.

Prime contractors will be able to meet these new rules without performing the required minimum amount of work by themselves if they subcontract with a "similarly situated entity." The work performed or supplies provided by these entities will not be considered subcontracted for purposes of determining whether a disadvantaged prime contractor has complied with the new subcontracting limitations. Unfortunately, it is not precisely clear what qualifies as a "similarly situated entity." Clearly, for example, a HUBZone subcontractor on a HUBZone set-aside contract is "similarly situated." But is a women-owned small business similarly situated? Both are small businesses, although classified under different disadvantaged business categories. Although the NDAA did not require the SBA to issue new rules regarding these new limitations, we would expect they will in order to provide additional clarity to the contracting community.

Interesting, the NDAA did not specifically outline new rules for set-aside construction contracts other than to require the SBA to develop new rules once consistent with the NDAA mandates for service and supply contracts.

A significant change to subcontracting limitations under the NDAA is the imposition of monetary penalties for violations of these rules. Previously, there was no explicit financial pain if the limitations were exceeded. Now prime contractors which are found to have violated the new regulations as set forth by the NDAA will be penalized with the greater of \$500,000 or the dollar amount in excess of permitted levels expended by the entity on subcontractors.

These changes will undoubtedly cause difficulty in the near term for both small and large businesses alike, as well as for contracting officers, as adjustments are made in allocating workload on certain contracts. While no doubt these changes are intended to insure that small and disadvantaged businesses reap the true economic benefits of set-aside programs, as a practical matter many small and disadvantaged business simply will not be able to perform under these new limitations without significant adjustment to their business planning.

Past Performance Evaluations – Section 1653

The NDAA seeks to compel contractors to make good faith efforts to comply with their subcontracting plans. Under previous rules, a prime contractor's failure to comply with a subcontracting plan would not be considered in a past performance evaluation of a contractor. Contracting officers could only consider an offeror's past achievement of its subcontracting goals as an evaluation factor when awarding a new contract. The new rules, outlined in Section 1653, continue to designate a failure to comply with a subcontracting plan as a material breach of a contract but also create the opportunity for such breaches to be considered in past performance evaluations. In addition, the new provisions create a reporting mechanism which will allow a subcontractor to report fraudulent activity or bad faith by a contractor in conjunction with a subcontracting plan.

To discourage contractors from the practice of identifying small businesses in their small business subcontracting plans but not notifying the small business (usually because there is little or no intent to utilize the small business), the NDAA requires prime contract offerors to notify the small businesses who are submitted with their plans. This notification process is presumably intended to empower small business subcontractors when a small business

subcontracting plan is not followed.

Fraud — Sections 1681 and 1682

Anti-fraud provisions in Section 1682 of the NDAA seek to eliminate propensities for small business misrepresentation, while at the same eliminating liability for misrepresentations undertaken without the intent of fraud. The removal of language requiring an actionable misrepresentation to "indicate a lack of business integrity and directly affect the present responsibility to perform any contract awarded by the Federal Government or a subcontract under such a contract," lowers the standard by which a misrepresentation can lead to suspension or debarment. At the same time, Section 1681 eliminates liability for certain misrepresentations by providing a safe harbor to contractors whose misrepresentations occurred as a result of good faith reliance on a written advisory opinion issued by the Small Business Development Center or an entity participating in the Procurement Technical Assistance Cooperative Agreement Program.

Small Business Miller Act Bonds — Section 1695

Certain federal contracts require contractors to post payment, performance and other forms of bonds or surety to protect the government and lower tier subcontractors. As a key example, the Miller Act (40 U.S.C. 3131 et. seq.) requires construction contractors to post payment and performance bonds to ensure contract completion in the event of a default and to ensure subcontractor invoices are paid. The Small Business Investment Act of 1958 authorized the SBA to provide backup guarantees to permit sureties to provide bonds to otherwise unbondable small businesses. However, the SBA could only guarantee those bid bonds, payment bonds and performance bonds for contracts up to \$2 million. Section 1695 now allows the SBA to guarantee such bonds for any work order or contract up to \$6.5 million. This increase will provide an opportunity for some small business contractors to compete for larger bonded contracts than they could have before.

Elimination of Women-Owned Small Business Contract Caps — Section 1697

A key provision of the NDAA aims to increase the number of available business opportunities for women contractors. By striking subparagraph (D) of Section 8(m)(2) of the Small Business Act (15 U.S.C. 637(m)(2)(D)), Section 1697 eliminates the previously existing contract caps for women-owned small business contractors. Under previous rules, set-aside contracts for women could not exceed \$6.5 million for manufacturing contracts and \$4 million for all other contracts. The elimination of the pre-existing caps will likely precipitate an increase in the amount of set-aside contracts available for women and also spur greater market participation from women-owned small businesses.

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