

SBA Finalizes Important Rule Changes for Limitations on Subcontracting, Affiliation & Joint Ventures

By Ryan Spiegel

On May 31, 2016, the U.S. Small Business Administration (SBA) issued a final rule amending the regulations related to small business and socioeconomic program set-aside contracts and small business subcontracting. While the rule addresses a number of different regulations, the most significant items affecting small businesses who contract with the government via set-asides, including 8(a), SDVO, HUBZone, and WOSB/EDWOSB, involve amendments to the restrictions on subcontracting and joint ventures, as well as changes to the way that affiliation is determined for purposes of calculating size.

The “Limitations on Subcontracting” regulation, 48 C.F.R. 52.219–14, had previously been tied to the cost of contract performance incurred for personnel or to the cost of manufacturing the supplies. The small business prime contractor was required to incur at least 50% of that cost in-house. But with this amendment, the limitation will now be evaluated based on the percentage of the overall award amount that a prime contractor spends on its subcontractors – representing a major change. Whether a contract is for services, supplies, or construction will not matter anymore for purposes of the method of determining compliance with the limitations on subcontracting, though the percentages will continue to vary depending on the type of contract (e.g., 50% of the overall award for service and supply contracts, 15% for general construction, and 25% for specialty trade construction). Additionally, the percentage of the award amount that the prime contractor spends on “similarly situated entity subcontractors,” i.e., other qualified small businesses eligible for the same set-aside, is *excluded* from the limitation. This means that subcontracts to such similarly certified small businesses will *not* count toward the limitation on subcontracting otherwise imposed on prime contractors on a set-aside.

As for determinations of affiliation for purposes of size calculation, the new rule clarifies that a presumption of affiliation exists for firms that conduct business with each other and are owned and controlled by persons who are married couples, parties to a civil union, parents and children, and siblings. This presumption is rebuttable and is based on precedent from OHA size appeal decisions interpreting the existing regulation. The rule also adopts a rebuttable presumption of affiliation based on economic dependence, establishing for the first time an explicit percentage threshold within the regulations. If a business derives 70% or more of its average annual revenue over the previous three years from another firm, then SBA will presume that the one firm is economically dependent on the other and, therefore, that the two firms are affiliated. Previously there had been no fixed percentage threshold in the regulations, but prior OHA size appeal decisions had used 70% as a guide.

Lastly, in keeping with the changes to the Limitations on Subcontracting that exclude “similarly situated entity subcontractors,” the rule broadens the ability of two or more small businesses to bid as a joint venture without being considered affiliated. Previously only mentor-protégé joint ventures and those bidding on bundled or large procurements were excluded from affiliation for small business size status. Now, a joint venture of two or more small businesses may submit an offer as a small business on any set-aside, so long as each member of the joint venture is small under the size standard corresponding to the NAICS code assigned to the contract.

The final rule, which implements certain provisions of the National Defense Authorization Act of 2013, is published in the Federal Register at Vol. 81, No. 104 and is scheduled to go into effect June 30, 2016. These significant changes should help streamline and reduce the regulatory burdens and make it easier for small businesses to obtain set-aside awards. However, understanding the details of the rule’s application in a specific situation can be confusing. Please contact us if you require help navigating the rule’s requirements.