

SBA Regulations, 78 Fed. Reg. 42391, July 16, 2013.

These regulations change the small business subcontracting program, and have implications for large and small businesses.

Key provisions of the subcontracting program:

- New rules become effective Aug. 15, 2013. They will also be implemented in the FAR and DFARS.
- Application is to solicitations issued on or after the effective date, according to the explanatory notes. However, the FAR implementation might apply some requirements to existing contracts.
- Thresholds have increased. Subcontracting plans are required for contract awards to a large business concern above a threshold of \$650,000 (\$1,500,000 for construction of a “public facility”), if there is an opportunity for subcontracting.
- A “subcontract” is now defined as “any agreement” for supplies and services required for prime contract performance, other than an employer-employee relationship.
- The subcontracting base excludes: (1) internally-generated costs (e.g., salaries and wages), (2) depreciation, (3) interest, (4) income and property taxes, (5) lease payments, and (6) certain other enumerated costs. The list in the regulations is not exhaustive, and other costs can be excluded.
- Purchases from affiliates are a “pass through,” *i.e.*, the affiliate’s subcontracts are counted as subcontracts of the prime contractor.
- Subcontracting plans are required for multiple-award indefinite-quantity contracts (including GSA MAS contracts), when the estimated value of the contract exceeds the dollar threshold. Annual reports are required for orders under such contracts.
- Subcontracting plans are required when a modification raises the contract amount above the dollar threshold. (Previously, this was required only when the modification itself was above the dollar threshold).
- Prime contractors must assign a NAICS code for each subcontract, using the same SBA rules as apply to contracting officers. Whether these codes were proper is part of the compliance review by the contracting officer.
- The threshold for pre-award notification to unsuccessful small business subcontract offerors (when there is a preference for small businesses) increases to \$150,000. (The explanatory notes say that a “preference” is where “consideration for award was limited based on size or socioeconomic status”).
- Prime contractors must monitor their subcontractors’ performance under their own subcontracting plans for the contract. This is also part of the contracting officer’s compliance review.
- If a large business prime contractor “uses” a small business in preparing its bid or proposal, it must make a “good faith effort” to subcontract from that business “in the same scope, amount and quality.” If it doesn’t, the prime must provide a written explanation to the contracting officer before submitting a final invoice.

- For these purposes, a large business prime “uses” a small business in preparing its bid or proposal if (1) it references the small business in the bid, proposal, or subcontracting plan, or if (2) it has an “agreement in principle” to subcontract with the small business, or if (3) the bid or proposal uses material drafted by the small business, or uses pricing, cost information or technical information from the small business, *and* there is written evidence of an “intent or understanding” to award a subcontract.
- Prime contractors must report in writing to the contracting officer, and provide an explanation, if they pay a small business contractor a reduced price, or if they are more than 90 days delinquent in payment, after the small business is entitled to payment under the subcontract.
- Prime contractors cannot prohibit subcontractors from discussing “payment or utilization” with the contracting officer.
- Prime contractors must also provide a written explanation if they fail to meet their subcontracting goals.
- Contracting officers must determine if the failure to meet subcontracting goals happened in spite of the contractor’s good faith efforts.
- Contracting officers must determine if payment of a reduced price, or a delinquency in payment or more than 90 days was justified.
- Contracting officers must consider the contractor’s lack of good faith efforts to achieve subcontracting goals, and its unjustified failure to pay a subcontract price in full or within 90 days, in the evaluation of past performance.
- Contracting officers will report contractors with a history of unjustified untimely or reduced payment (defined as three incidents within 12 months) to FAPIIS.
- Contracting officers may require a small business subcontracting plan if a contractor’s status changes from small to large as a result of a size recertification (and the contract otherwise would require such a plan).
- Contracting officers also have discretion to require a prime contractor to update its subcontracting plan when an option is exercised. (This is now in the FAR).
- Contracting officers can establish goals as a percentage of total contract dollars, as well as a percentage of subcontract dollars.
- If the subcontract includes prescribed language, prime contractors may rely on their subcontractor’s certification of size status in SAM. However, the prime contractor cannot require its subcontractor to register in SAM.

Areas of uncertainty:

- Are 1099 workers (“independent contractors”) considered “subcontractors” for these purposes?
- How broad is the exception for “merely responding to an RFQ” in the rules for use of a small business in preparing a bid or proposal?
- To add other costs to the list of those excluded from the subcontracting base, is it sufficient to list them in an approved plan?

- For cost-type contracts, is “a final invoice for contract closeout” the one submitted after indirect cost rates are settled and finalized? Does litigation that could lead to another payment delay the “final invoice”?
- What is an “agreement in principal” to subcontract? Does a teaming agreement suffice? (The explanatory notes say that contracting officers will interpret this on a case-by-case basis.)
- “Public facility” (for application of the \$1.5M threshold) is undefined.
- What standards will the contracting officer use in determining whether a late or reduced payment is justified? Will these determinations be subject to the disputes process (as is likely)?
- If the FAR implementation of these rules applies some of them to existing contracts, will contractors get reimbursed for the added costs of compliance?

Implications for large business prime contractors:

- It is necessary to update subcontracting processes, across the board, to comply with the new requirements.
- Large businesses may be able to improve their subcontracting percentages by excluding costs from the subcontracting base.
- A prime contractor might want to avoid taking steps that SBA defines as “using” a small business in preparing its bids or proposals.
- Primes need to have a good justification for not reporting a reduced or late payment as “justified.” These topics should be addressed in the subcontract.

Implications for small business subcontractors:

- Small businesses have a greater expectation of getting a contract if they team with a large business.
- Small businesses can take unresolved payment issues up with the contracting officer.
- Under certain circumstances, small businesses can also complain to contracting officers if they do not receive a subcontract, or if it is smaller than expected.