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End-Of-Summer Recap For Government Contractors

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It's been a busy summer for government contractors, with a torrent of regulatory changes, and even one U.S. Supreme Court decision interpreting small business regulations.


Daniel S. Koch

Here's a recap of six key developments that every government contractor should know about before charging into the fiscal year-end frenzy.

1. New Version of 51 Percent Rule for Small Business Subcontracting

Limits on subcontracting will now be calculated differently: Instead of requiring the prime contractor to itself perform more than 50 percent of the cost of a set-aside contract, now the prime contractor must not subcontract more than 50 percent of the price of the prime contract, focusing only on the price for services (in a services contract) or products (in a supplies contract), and excluding expenses (other direct costs).

Furthermore, subcontracts to the same type of contractor (small business to small business, woman-owned to woman-owned, 8(a) to 8(a), etc.) will not count as subcontracted, so long as the subcontractor does not itself further subcontract the work. Compliance will be tested for the initial contract period, and for each option period, although the contracting officer has discretion to apply the limitation separately to each order. For the first time, noncompliance can result in penalties.

The Small Business Administration's long-awaited final rules, directed by the 2013 National Defense Authorization Act, also contain many other important provisions about affiliation, small business joint ventures and other topics. These final rules took effect June 30, 2016.

2. Supreme Court's Kingdomware Decision

The Supreme Court opened new opportunities for small-business set-aside contracting, in its Kingdomware decision on June 16, 2016. That decision held that the Veterans Administration must set aside for small businesses all procurements, including Federal Supply Schedules (General Services Administration Schedule) purchases, whenever the "rule of two" is satisfied. In that case, the rule of two required VA contracting officers to set aside contracts for veteran-owned small businesses whenever they had a reasonable expectation that at least two VOSBs would bid for the work at a fair and reasonable price.

The decision only applies to VA procurements, but its reasoning should lead to government-wide

application. Small businesses should consider requesting that any opportunity they could fulfill be set aside, whenever another capable small business can be persuaded to also make a request, so that the rule of two can be satisfied.

Failure to set aside a procurement when the rule of two is satisfied may be vulnerable to protest. Larger businesses can help small businesses meet a requirement, but must be careful to structure the teaming arrangement to avoid affiliation pitfalls.

3. SBA Expanded Mentor-Protege Program

The SBA expanded its mentor-protege program, previously limited to its 8(a) Business Development program for disadvantaged-minority owned firms, to all small businesses. This change was effective Aug. 24, 2016, and also implemented statutory direction in the 2013 NDAA.

Mentors should help develop the ability of proteges to win and perform contracts. Mentors must provide proteges with technical or management assistance, financial assistance, or more notably, assistance in the form of subcontracts to or from the protege, or assistance with performance of prime contracts in the form of joint ventures. A mentor can have up to three proteges.

Most importantly, a protege may joint-venture with its SBA-approved mentor, and will still qualify as a small business, provided that it meets the size standard for the NAICS code for that procurement. Similarly, a service-disabled veteran-owned company, woman-owned small business or HUBZone company can joint-venture with its mentor, if it qualifies for those programs.

Therefore, small businesses might consider recruiting large business mentors, to help with particular types of procurements; and large businesses might select small businesses to qualify for categories of set-aside procurements of interest. The SBA must approve all mentor-protege agreements.

The mentor-protege agreement will renew annually, for up to three years, with an optional second three-year term; but the SBA will review the mentor's assistance and the progress of the protege annually, and may terminate the agreement in cases of noncompliance. Furthermore, noncompliance with mentor-protege requirements may be grounds for suspension or debarment.

The SBA is anticipating an onslaught of applications, leading to delays in approving mentor-protege agreements. Both large and small businesses should consider acting quickly, to take advantage of now-broader opportunities to compete for set-aside contracts.

4. Basic Cybersecurity Safeguarding Requirements for Contractor Information Systems

The U.S. Department of Defense cybersecurity rules published in 2015 commanded all the attention, but effective June 15, 2016, new minimum government-wide cybersecurity requirements apply to all new contracts. The rule covers any contractor information systems that process, store or transmit nonpublic information provided by or generated for the government under a contract.

The rule imposes 15 specific security requirements, described as controls that any "prudent business person" would implement. Less rigorous than the DOD rule, the requirements include limiting access to authorized users, and verifying their identity, by means such as passwords; limiting physical access, and maintaining audit logs of physical access; identifying, reporting and correcting system faults in a timely manner; maintaining anti-malware protection, and updating it when new releases become available,

etc.

The clause must be flowed down to subcontracts, and applies to acquisitions of commercial items, except for commercial off-the-shelf items. New Federal Acquisition Regulation clause 52.204-21 should appear in all contracts awarded after June 15, 2016.

5. Increased Threshold for Exemption From Overtime Pay

The minimum salary at which employees may become exempt from overtime pay will rise to $47,476, more than double the previous level of $23,660, effective Dec. 1, 2016. Any employee earning less than that amount must be paid 1.5 times his or her hourly rate, for all hours exceeding 40 per week; an employee earning more than that amount may be exempt from overtime, but only if his or her duties satisfy one of the tests for exemption.

Any contractor with employees earning less than $47,476, who are working under a federal contract for more than 40 hours per week and presently considered exempt, will face an expensive surprise when this change takes effect later this year.

6. New GSA Schedules Data Reporting Obligations, and Different Possibility of Price Reductions

Most contractors know that the GSA's Federal Supply Schedules include a price reduction clause, under which the contractor risks liability for refunds to the government, if the GSA finds that the contractor charged the government a price higher than that charged to a reference customer. Avoiding that danger, by monitoring prices charged, has always been burdensome.

This summer, the GSA announced elimination of the price reduction clause, removing the No. 1 headache for GSA Schedule holders. However, the GSA introduced a new burdensome requirement: transactional data reporting (TDR). The new clause requires contractors to track and to report sales, by line-item, to the GSA monthly, even if there are no sales. Sales to federal customers are included. The GSA describes TDR as a pilot program that will begin later this year (at a date not yet announced) and that it will review after a one-year trial period.

TDR will apply to about 30 percent of FSS contracts, notably, for Schedule 70 (General Purpose Information Technology), certain Special Item Numbers (SINs), including 132-8 (hardware), and 132-32, 132-33, and 132-34 (software). For Schedule 70 holders, if reporting is required for any SIN, reporting will be required for all SINs. Therefore, if a Schedule 70 holder is required to report software or hardware sales, it will also be required to report professional services SINs.

All newly awarded FSS contracts on the GSA's list of schedules initially in the pilot program will be subject to transactional data reporting. However, existing schedule holders in those categories will be brought into the program by bilateral modification, which contractors could presumably decline. The new clause will also apply to the GSA's non-FSS government-wide acquisition vehicles, for solicitations issued on or after June 23, 2016.

What will the GSA do with the TDR data? First, the GSA's COs will use it to determine whether initial FSS price proposals are fair and reasonable. Second, the COs are empowered to request a temporary or permanent price reduction at any time during the contract period.

In other words, TDR allows the GSA to request price reductions, now based not upon a contractor's sales

to reference customers, but upon its sales to any of its federal customers, or even upon other contractors' sales to their commercial or federal customers. Presumably, not complying with the request to reduce prices could lead to removing that item from the Schedules.

The implications of GSA's new rule are complex. FSS holders in the categories first affected — including hardware and software vendors on Schedule 70 — should pay heed immediately, and others should monitor developments.

The summer has been a busy season for government contractors, even before the busy season has begun. Contractors — and their counsel — may want to pause and explore the important details of these potentially far-reaching changes.

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