

How VA Circumvents High Court Kingdomware Decision

By Daniel Koch and Stephen Ramaley

Law360, New York (September 5, 2017, 12:43 PM EDT) -- Last year the U.S. Supreme Court in *Kingdomware Technologies Inc. v. United States*[1] appeared to have settled a long-standing dispute about whether the U.S. Department of Veterans Affairs must prefer service-disabled veteran-owned small businesses (“SDVOSBs/VOSBs”), instead of purchasing products or services from the General Service Administration’s Federal Supply Schedules. The Supreme Court ruled against the VA, holding that pursuant to the Veterans Benefits, Healthcare and Information Technology Act of 2006,[2] the VA was required to set aside a procurement whenever two or more SDVOSBs/VOSBs are expected to submit a responsive offer at a reasonable price, i.e., whenever “the rule of two” is satisfied.



Daniel Koch

The VA, however, apparently is not taking no for an answer. The VA is pursuing a somewhat stealthy strategy that appears targeted to continue, in part, its pre-Kingdomware resistance to setting aside procurements for veteran-owned firms. Contractors should be on guard, and interested parties should be prepared for advocacy opportunities — or protests.

The VA’s Strategy to Partially Circumvent Kingdomware

The VA appears to have adopted a strategy to circumvent the Kingdomware ruling, at least for procurements of products. Contractors that supply products to the VA, particularly SDVOSBs/VOSBs, should pay close attention.



Stephen Ramaley

The “Nonmanufacturer Rule”

The VA’s strategy involves the so-called “nonmanufacturer rule,”[3] which applies to set aside procurements when the contractor resells items manufactured by another party, i.e., whenever the contractor is a reseller/distributor/“nonmanufacturer.” Under the rule, a nonmanufacturer can bid on a set-aside procurement only when, among other requirements, its products were manufactured by a small business in the United States.

The Existing Waiver Process That Facilitates Small Business Set-Asides

However, for products for which there are no domestic small business manufacturers, the Small

Business Administration will waive that requirement, so that a small business nonmanufacturer can supply products manufactured by large companies (a “waiver”). Under Federal Acquisition Regulation and SBA regulations, contracting officers (“COs”) have the power to decide whether existing SBA waivers apply to procurements, or to ask SBA for new waivers.[4]

Whether a waiver applies could determine whether a procurement will be set aside for small businesses. If a waiver applies, two or more small businesses, including SDVOSBs/VOSBs, can tell the VA that they can fulfill the requirement, satisfying the “rule of two,” and the CO will set the procurement aside. But if no waiver applies, nonmanufacturers must supply the product of a small business manufacturer. If no small business manufacturer’s product exists to supply, but no waiver is applied, the procurement will not be set aside, i.e., the procurement will become full and open.

Up until now, COs at the VA (as elsewhere) would decide whether one of SBA’s existing waivers applied to a procurement, or whether to seek a new waiver specific to the procurement.[5]

VA Policy Memorandum Alters the Waiver Process and Negatively Impacts Small Business Set-Asides

On Feb. 17, 2017, about eight months after the Kingdomware decision, the VA published a policy memorandum[6] issuing a “class deviation,” a departure from the requirements of the FAR, applicable at the VA only. Under its policy memorandum, VA took waiver responsibilities away from its COs; now, instead, heads of contracting activities (“HCAs”) at the VA must approve any time a CO wishes to apply a waiver to a procurement.

The VA’s policy memorandum imposes a big new hurdle for non-manufacturer rule waivers. Instead of just deciding themselves, COs must also secure the approval of the HCA to waive the nonmanufacturer rule. There are many fewer HCAs, who are busy top-level supervisors; and the VA’s policy memorandum says that this authority may not be redelegated, i.e., the HCA must himself/herself approve.

Effectively, the VA’s policy memorandum will result in fewer set-aside procurements of this type at the VA. Even when the “rule of two” dictates that a procurement should be set aside for small businesses or SDVOSB/VOSB offerors, the VA has now interposed a potent procedural obstacle. It is difficult to conclude that the VA issued its policy memorandum for any purpose other than counteracting the impact of the Kingdomware decision, reducing the number of set-asides, and freeing the VA to resume buying from non-SDVOSBs/VOSBs through the FSS and other contractual means.[7]

Takeaways for Contractors

It remains to be seen whether the VA’s strategy passes legal muster. We anticipate disputes in the coming months between the VA, SBA and veterans’ business advocates over whether the VA can control nonmanufacturer rule waivers in this manner. These disputes may lead to yet another court showdown.

But for now, here are the three main takeaways:

1. The fight over veterans’ preferences is not over.

Despite the victory for veteran-owned contractors in Kingdomware, there is still no guarantee of SDVOSBs/VOSBs set-asides at the VA, and limiting nonmanufacturer rule waivers is only one of several strategies being employed. For example, even after Kingdomware, the VA stuck to its position that “AbilityOne”[8] vendors were preferred — at least for certain products — over SDVOSBs/VOSBs.

However, on May 30, 2017, in *PDS Consultants Inc. v. United States*,^[9] the U.S. Court of Federal Claims rejected the VA's position, holding that Kingdomware established that the preference for veterans is the "VA's first priority ... 'in all contracting.'"^[10]

While the *PDS Consultants* case was yet another victory for SDVOSBs/VOSBs, the case illustrates that the VA's efforts to restrict set-asides have been, and likely will continue to be, ongoing. In such an environment, it is likely that, if past experience is any guide, there will be other court challenges.

2. Contractors affected by nonmanufacturer rule waivers at the VA should educate themselves on when such waivers should apply to a procurement.

The nonmanufacturer rule is not easy to understand, and the VA's policy memorandum may be exploiting the complexity of the rule in order to limit set-aside opportunities. Therefore, contractors need to educate themselves on the rule generally, and specifically on whether existing waivers may apply to products they intend to sell to the VA. The SBA maintains a list of existing waivers on its website.^[11] When there are no existing waivers, SDVOSBs/VOSBs should conduct their own market research to ascertain whether any U.S. small businesses manufacture the products they intend to supply to the VA. If not, SDVOSBs/VOSBs can advocate for the issuance of a new waiver. Knowledge and appropriate advocacy may be the initial best course to counter efforts to reduce the number of set-aside opportunities.

3. To the extent the HCA (or the CO) determines not to apply an ostensibly applicable waiver, contractors should consider protesting or seeking redress through administrative and/or legislative action.

Kingdomware instructed the VA to perform a "rule of two analysis" for SDVOSBs/VOSBs in "all contracting," and whenever the rule is satisfied, the procurement must be set aside. However, the VA policy memorandum could result in a situation in which two or more SDVOSBs/VOSBs can provide the product under a nonmanufacturer rule waiver, but the cognizant HCA has not affirmatively approved the use of the waiver, and thus the procurement has not been set aside. In these situations, SDVOSBs/VOSBs should consult government contracts legal counsel. The failure to set aside the procurement may be protestable. Further, in addition to protesting, or whenever a protest is not possible or practical, contractors could inform the SBA and/or Congress that nonmanufacturer rule waivers are not being applied as intended. These other stakeholders could, on their own or acting together, persuade the VA to follow the letter and spirit of the law and set the procurement aside.

Daniel S. Koch is a counsel in the Rockville, Maryland, office of Miles & Stockbridge PC. Stephen P. Ramaley is an associate in the firm's Tysons Corner, Virginia, office.

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[1] 579 U.S. _____ (2016).

[2] 38 U.S.C. § 8127 et seq.

[3] 13 CFR 121.406(b)

[4] FAR § 19.102(f); 13 CFR § 121.1204.

[5] 13 CFR § 121.1203(procedures for individual waivers); 13 CFR § 121.1206 (“Contracting officers must provide written notification to potential offerors of any waivers being applied to a specific acquisition, whether it is a class waiver or a contract specific waiver.”)

[6] https://www.va.gov/oal/docs/business/pps/deviationVaar819102_20170217.pdf.

[7] The VA’s proffered justification for the class deviation is to “to ensure HCAs have situational awareness of issues prompting the requests or use and, if needed, can take actions to mitigate requests or use.” See n.6, *supra*.

[8] The AbilityOne Program facilitates the employment persons who are blind or who have other significant disabilities.

[9] No. 16-1063C (2017).

[10] *Id.* at 21 (quoting Kingdomware).

[11] <https://www.sba.gov/contracting/contracting-officials/non-manufacturer-rule/class-waivers>.