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Successful Partnering Between Large and Small Contractors to Win Federal Work

Diana Lyn Curtis McGraw, Nicholas T. Solosky & Morgan M. Tapp | Fox Rothschild

The U.S. Small Business Administration (SBA)'s Mentor-Protégé Program is a keystone for helping small businesses obtain increased federal contracting opportunities. Through the Program, eligible protégés and approved mentors can form joint ventures to pursue restricted, set-aside federal work. The protégé may also receive financial, technical, and managerial assistance from its mentor (consistent with an approved Mentor-Protégé Agreement). On the other side of the equation, mentor firms receive the same access to restricted, set-aside work and can also rely on the joint venture relationship to receive credit toward small business subcontracting goals.[2]

While the Program offers substantial benefits to both small and large businesses, participants need to be sure to comply with the applicable SBA regulations at every turn. Without appropriate Mentor-Protégé and joint venture agreements, the joint venture may be challenged in a size protest and lose. That outcome is particularly devastating for the small business, which can no longer compete in the restricted marketplace caused by the affiliation with the mentor.

To comply with SBA's regulations, it is important for federal contractors (both small and large) performing on set-aside contracts to continuously monitor SBA's policies and rules as they continue to develop over the years. To that end, on September 9, 2022, the SBA issued a proposed rule for "Ownership and Control and Contractual Assistance Requirements for the 8(a) Business Development Program." The proposed rule seeks to clarify some parts of regulations and makes several revisions that incorporate "a statutory amendment from the National Defense Authorization Act for Fiscal Year 2022 and blanket purchase agreements in the list of contracting vehicles that are covered by the definitions of consolidation and bundling…."[3]

This article focuses on the following four topics: (1) Populated Joint Ventures; (2) SBA Orders v. Contracts; (3) The Ostensible Subcontractor Rule; and (4) Specific issues affecting 8(a) businesses.

1. Populated Joint Ventures

The current rule regarding populated joint ventures states: "[A joint venture that] exists as a formal separate legal entity, ***may not be populated*** with individuals intended to perform contracts awarded to the joint venture."[4] While the current rule permits joint ventures that are separate legal entities to be populated ***by administrative personnel***, the rule confused contractors as to when a joint venture may/may not be populated.

Under prior versions of this rule from before November 2020, a joint venture could not be populated – meaning the joint venture itself could not hire its own employees to perform the government contract. Instead, each joint venturer provided its own employees to perform the contract work on behalf of the joint venture as an "unpopulated" joint venture. This unpopulated setup enabled the SBA to track the performance of each venturer on the contract to ensure the small business partner receives the intended benefit from the joint venture arrangement. The current rule changed these requirements slightly to allow a joint venture to hire its own administrative personnel, including one or more Facility Security Officers. 13 C.F.R. §121.103(h).

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[1] Congressional Research Service, *Small Business Mentor-Protégé Programs*, https://sgp.fas.org/crs/misc/R41722.pdf (Jun. 10, 2022).

[2] *Id.*

[3] Small Business Administration, Ownership and Control and Contractual Assistance Requirements for the 8(a) Business Development Program, 87 FR 55642, https://www.federalregister.gov/documents/2022/09/09/2022-18068/ownership-and-control-and-contractual-assistance-requirements-for-the-8a-business-development (September 9, 2020).

[4] 13 C.F.R. of §121.103(h) (emphasis added).

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Now, the new proposed rule seeks to clarify the following:

- The rule requiring joint ventures to be unpopulated applies ***only*** to contracts set aside or reserved for small business, such as small business set-aside, 8(a), women-owned small business (WOSB), HUBZone, and service-disabled veteran owned small business (SDVOSB) contracts.
- A populated joint venture could be awarded a contract set-aside or reserved for small business ***if*** each of the partners to the joint venture were similarly situated.
- For populated joint ventures, ***revenue must be divided*** according to the same percentage as the joint venture partner's percentage ownership share in the joint venture.

2. SBA Orders v. Contracts

Prior to November 2020, if a joint venture was awarded more than three contracts over a two-year period, the parties to the joint venture would be considered "affiliated" and lose their small business status (commonly referred to as the Three-in-Two Rule). SBA's current rule stopped counting contracts and instead looked to the duration – the joint venture cannot exceed two years from the date of its first contract award, regardless of how many contracts the entity performed in the two-year period.

Under the new proposed rule, the SBA seeks to clarify a distinction between orders (for example, under a Multiple Award Task Order Contract (MATOC) and contract awards: "SBA's current policy is to allow ***orders*** to be issued under previously awarded contracts beyond the two-year period."

In order to clarify whether ***orders*** beyond the two-year period are permissible, the proposed rule would add a sentence "a joint venture may be issued an ***order*** under a previously awarded contract beyond the two-year period."

3. The Ostensible Subcontractor Rule

The Ostensible Subcontractor Rule targets small businesses that are unusually reliant on a large subcontractor partner to perform the primary and vital functions of a contract. A small business must avoid falling under the Rule, which results in a finding of affiliation and potentially the loss of small business size status.

In the proposed rule, the SBA highlights the following key clarifications/changes to the Ostensible Subcontractor Rule:

- Ostensible Subcontractor Rule for general construction contracts should be applied to the management and oversight of the project – not to the actual construction or specialty trade construction work performed. The prime contractor ***must*** retain management of the contract but may delegate a large portion of the actual construction work to its subcontractors.
- SBA proposed to add two of the four *DoverStaffing* factors to determine the ostensible subcontractor relationship: the reliance on incumbent management and the reliance on the subcontractor's experience. Still, SBA would consider all aspects of the prime contractor's relationship with the subcontractor and would not limit its inquiry to the enumerated *DoverStaffing* factors, which show when a prime contractor's relationship with a subcontractor implies ***unusual reliance***.[5]

[5] *See Size Appeal of DoverStaffing, Inc.*, SBA No. SIZ-5300 (2011) (noting that the *DoverStaffing* factors are (1) the proposed subcontractor is the incumbent contractor and ineligible to compete for the procurement, (2) the prime contractor plans to hire the large majority of its workforce from the subcontractor, (3) the prime contractor's proposed management previously served with the subcontractor on the incumbent contract, and (4) the prime contractor lacks relevant experience and must rely upon its more experienced subcontractor to win the contract).

- SBA would apply the ownership and control requirements for Small Business Innovation Research (SBIR) / Small Business Technology Transfer (STTR) joint ventures.
- If the ostensible subcontractor qualifies independently as a small business, a size protest would not find the affiliation between prime contractor and its ostensible subcontractor ineligible for any small business contract.

4. Issues Affecting 8(a) Companies

The proposed rule suggests making several changes related to 8(a) contracts. For example, currently, 13

C.F.R. § 124.604 requires "each Participant owned by a Tribe, ANC, NHO or CDC must submit to SBA information showing how the Tribe, ANC, NHO or CDC has provided benefits to the Tribal or native members and/or the Tribal, native or other community due to the Tribe's/ANC's/NHO's/CDC's participation in the 8(a) BD program through one or more firms." Now, the proposed rule would require participants to provide more precise benefits provided back to the Native Community through a "Community Benefits Plan," which outlines the "anticipated approach it expects to deliver to strengthen its Native or underserved community over the next three or five years." Some other key points include the following:

Good Faith Effort

Under the current 13 C.F.R. 124.509(d)(4), if a Participant fails to make ***good faith efforts*** to meet its applicable non-8(a) business activity target, the SBA may prohibit the award of any new, sole-source 8(a) contracts. SBA's new proposed rule provides guidance on what "good faith efforts" means. Particularly, a Participant could show good faith efforts by demonstrating to SBA that (1) "it submitted offers for one or more non-8(a) procurements which, if awarded, would have given the Participant sufficient revenues to achieve the applicable non-8(a) business activity target during its just completed program year;" or (2) there were "**extenuating circumstances** that adversely impacted its efforts to obtain non-8(a) revenues."

Extenuating circumstances would include, but not be limited to:

- reduction in government funding
- continuing resolutions and budget uncertainties
- increased competition driving prices down
- having one or more prime contractors award less work to the Participant than originally contemplated.

Bona Fide Place of Business

15 U.S.C. § 637 notes that "[t]o the maximum extent practicable, construction subcontracts awarded by the Administration pursuant to this subsection shall be awarded within the county or State where the work is to be performed." That said, 13 C.F.R. §124.501 requires participants to have a ***bona fide place of business*** within a specific geographic location. This "maximum extent practicable" requirement applies to both sole source and competitive 8(a) construction contracts. The proposed rule clarified what would constitute as a bona fide place of business:

- a specific state where a Participant is currently performing a contract would qualify as having a bona fide place of business in that state.
- full-time employee in a home office.

- For a single award 8(a) construction contract requiring work in multiple locations, where a majority of the work is to be performed.
- For a multiple award 8(a) construction contract, in any location where work is to be performed.

Final Takeaways

SBA's new proposed rule clarifies various terms and regulations relating to joint ventures and 8(a) companies. While this article does not discuss all the changes proposed by SBA, business that are part of the Mentor-Protégé Program are encouraged to review the proposed rule in full detail, and/or submit comments to SBA by November 8, 2022.

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Buy American Act and Trade Agreements Act Requirements, Compliance and Enforcement

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The federal government has a long-standing preference for using domestic supplies and construction materials in federal procurements. The general rule for federal procurements is that all products provided or sold to the government must be of domestic origin unless an exception to this general rule exists. These domestic preferences are governed by a complex framework of statutes and regulations, prohibitions and waivers, and rules and exceptions that are often difficult for contractors to understand and follow.

It is crucial that all federal contractors understand these requirements and domestic preferences to avoid the significant penalties that may be imposed for any failure to comply. This memorandum provides a brief overview of Buy American Act (BAA) and Trade Agreements Act (TAA), and discusses pending changes to those and other statutes.

1. Buy American Act of 1933 (BAA)

The BAA generally requires that the federal government purchase "domestic end products" and use "domestic construction materials" on covered federal contracts.

Federal Construction Materials

A construction material is "an article, material, or supply brought to the construction site by a contractor or subcontractor for incorporation into the building or work."[1] This definition makes clear that all materials "brought" to a construction site for "incorporation" into the project, whether they are actually used on the project or not, must be of domestic origin, or a "domestic construction material." Therefore, contractors must ensure that before any material is actually shipped to a project site that the materials comply with the BAA requirements.

The BAA defines a "domestic construction material"[2] as follows:

(A) An ***unmanufactured construction material*** mined or produced in the United States;
(B) A ***construction material manufactured in the United States***, if:
(1) The cost of the components mined, produced, or manufactured in the United States exceeds 55% of the cost of all its components. Components of foreign origin of the same class or kind for which nonavailability determinations have been made are treated as domestic. Components of unknown origin are treated as foreign; or
(2) The construction material is a COTS [commercial off-the-shelf] item.

An ***unmanufactured construction material*** is raw material brought to a construction site for incorporation into the project. An unmanufactured material is one that is not processed into a specific form or combined, in advance, with other raw materials to create a new material. In general, it is relatively uncommon to encounter an unmanufactured construction material on the project site as the vast majority of construction materials are modified, or "manufactured," in some manner prior to being delivered to a construction site.

A manufactured construction material is any material that does not qualify as "unmanufactured." The term "manufactured" simply means the "substantial transformation" of a product into the required form for use on a construction project. Manufactured construction materials are deemed to be "domestic construction materials" if they are "manufactured in the United States" and either (1) the cost of the components mined, produced, or manufactured in the United States exceeds 55% of the cost of all its components; or (2) the construction material is a COTS [commercial off-the-shelf] item.[3] Importantly, the threshold of 55% is scheduled to increase to 60%, beginning on October 25, 2022, and ultimately increase to 75% in the next several years.[4]

[1] FAR 25.003
[2] *Id.*
[3] *Id.*
[4] Executive Order 14005 was issued on January 25, 2021, directing agencies to close current regulatory loopholes "that allow companies to offshore production and jobs while still qualifying for domestic preferences." on March 7, 2022, the FAR Council published a long-awaited final rule implementing the Executive Order 14005. https://www.regulations.gov/document/FAR_FRDOC_0001-1662. The final rule further increases the percentage of domestic content components, initially from 55 percent to 60 percent upon effective date on October 25, 2022, to 65 percent in 2024, and ultimately to 75 percent in 2029.

Federal Supply Contracts

The BAA also governs government purchases of plain old supplies for government use. Under the BAA, agencies procuring goods for use in the United States under a contract greater than the micro-purchase threshold must use "domestic end products" unless otherwise permitted to use foreign end products as an exception to the general rule.[5]

Similar to domestic construction materials, a "domestic end product" is defined as follows under the BAA regulations:[6]

> (i) An unmanufactured end product mined or produced in the United States;
> (ii) An end product manufactured in the United States, if—
>> (A) The cost of its components mined, produced, or manufactured in the United States exceeds 55 percent of the cost of all its components. Components of foreign origin of the same class or kind as those that the agency determines are not mined, produced, or manufactured in sufficient and reasonably available commercial quantities of a satisfactory quality are treated as domestic. Components of unknown origin are treated as foreign. Scrap generated, collected, and prepared for processing in the United States is considered domestic; or
>> (B) The end product is a COTS item.

2. Exceptions to the BAA

In general, the BAA does not apply to certain government procurements under a handful of different and significant exceptions, some of which must be applied before a contractor submits its proposal for a specific government contract, and some of which can be implemented retroactively after a contract award is made. Some of the highlights of these exceptions include:

- The Contracting Officer determines whether the cost of a domestic construction material or domestic end product would be "unreasonable;"[7]
- The procurement value is at or below the micro-purchase threshold;[8] or
- The procurement of ***information technology*** that is a ***commercial product or commercial service***.[9]

Importantly, FAR 2.101 defines information technology as "any equipment, or interconnected system(s) or subsystem(s) of equipment, that is used in the automatic acquisition, storage, analysis, evaluation, manipulation, management, movement, control, display, switching, interchange, transmission, or reception of data or information by the agency," including "computers, … software, firmware and similar procedures, services (including support services), and related resources." Moreover, the FAR defines commercial product as a product "that is of a type customarily used by the general public or by nongovernmental entities for purposes other than governmental purposes; and [h]as been sold, leased, or licensed to the general public; or [h]as been offered for sale, lease, or license to the general public."

3. Trade Agreements Act of 1979 (TAA)

The TAA provides statutory waivers from the BAA's domestic end product requirements for "eligible products" made in "designated countries" that are subject to various trade agreements beneficial to the U.S. In other words, the TAA recognizes certain foreign-made products from specifically designated countries as if they were domestic products for the purpose of the BAA.

To qualify as a "designated country end product" under the TAA, the product must be manufactured or "substantially

[5] 41 U.S.C. § 8302
[6] The threshold is expected to increase from 55 percent to 60 percent upon effective date on October 25, 2022, to 65 percent in 2024, and ultimately to 75 percent in 2029.
[7] FAR 25.202(a)(3) (construction materials); FAR 25. 103(c) (supplies)
[8] 41 U.S.C. § 8302(a)(2)(C)
[9] FAR 25.202(a)(4) (construction); FAR 25.103(e) (supplies).

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transformed" in a TAA-designated country. The TAA regulations, which are generally found at FAR Subpart 25, are complex and consist of numerous rules and exceptions. It is imperative that contractors understand these rules to ensure that, when they provide a designated country end product for a federal procurement, the product truly complies with the BAA and TAA rules.

Unless an exception states otherwise, the TAA applies to procurements that equal or exceed the TAA threshold. Under the World Trade Organization (WTO) Agreement on Government Procurement (GPA) and certain Free Trade Agreements (FTAs), the TAA threshold is $183,000for supply and service contracts, and $7,032,000 for construction contracts. Certain FTAs have their own thresholds.[10]

4. Takeaways

Taken together, the BAA and TAA create a complex framework of rules and regulations. Contractors must understand and be able to comply with these rules to avoid allegations of non-compliance by the federal government. The penalties for failing to comply with any of these requirements can be stiff in the form of contract suspension and debarment, and significant civil and criminal penalties.

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[10] FAR 25.402

Pricing Strategies to Navigate Supply Chain Shortages

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Over the last year, 93% of the construction materials, equipment, and labor rates increased in cost.[1] Such an increase reflects a shortage in today's supply chain, notably in the construction sector. Unfortunately, the impact is more costly for federal contractors performing on firm-fixed-price contracts because the nature of the contract shifts maximum risk to the contractor. Therefore, without an effective pricing plan, contractors may face significant cost challenges in their businesses. This article introduces various pricing strategies for federal contractors performing on firm-fixed-price contracts and navigates evolving policies surrounding supply chain shortages.

1. Background: Firm-Fixed-Price Contract

Generally, agencies use firm-fixed-price contracts to acquire construction projects.[2] The Federal Acquisition Regulation (FAR) 16.202-1 explains that "[a] firm-fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss." Importantly, the FAR puts the burden on contractors to control costs and assume risk. This means that contractors should calculate the cost, as well as projected risks, and build everything into the price. However, it is inevitable that contractors nevertheless could incur additional costs when unexpected circumstances occur, such as an unprecedented inflation.

In private industry, contractors often use various clauses to mitigate risks. For example, parties often consider price escalation, contingencies and allowances, negotiation of responsibility for delays, time extensions, or Force Majeure clauses.[3] However, negotiations between government agencies are more complicated for contractors performing on federal firm-fixed-price contracts. That said, it is important for federal contractors to review solicitations and look carefully for the following clauses prior to pricing: (1) Force Majeure and (2) Economic Price Adjustment (EPA).

Force Majeure

Generally, firm-fixed-price contracts treat price escalation as a Force Majeure event, meaning that contractors can get a time extension for performance of the contract but must bear the cost risk of the extended performance. FAR 52.249-10(b) states that where a "delay in completing the work arises from unforeseeable causes beyond the control and without the fault or negligence of the Contractor," "[t]he Contractor's right to proceed shall not be terminated nor the Contractor charged with damages." This has become a very challenging situation for contractors on multiyear contracts that are fixed price. Therefore, it is crucial for contractors to understand that contractors are generally not excused from performing when there is an unforeseeable cause, and that contractors must also usually bear the cost risk.

Economic Price Adjustment Clause

When a firm-fixed-price contract has an economic price adjustment clause, a contractor may be able to adjust the stated contract price when the market price of materials increases at an unprecedented rate. Pursuant

[1] Gordian, *A Closer Look at 2022 Construction Cost Changes*, https://www.gordian.com/resources/2022-construction-cost-changes-closer-look/.
[2] FAR 36.207
[3] Notably, ConsensusDocs 200.1 Material Price Escalation Amendment is a great resource.

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to FAR 16.203-1, an EPA clause "provides for upward and downward revision of the stated contract price upon the occurrence of specified contingencies," including adjustments based on established prices, adjustments based on actual costs of labor or material, and adjustments based on cost indexes of labor or material. Specified contingencies may include "serious doubt concerning the stability of market or labor conditions that will exist during an extended period of contract performance."[4] It is encouraged for federal contractors to clarify the contingencies with the Contracting Officers prior to submitting the bids in order to avoid any future conflicts.

While an EPA clause does provide some protections to federal contractors, it comes with caveats. First, a fixed-price contract with economic price adjustment cannot be used "unless the contracting officer determines that it is necessary either to protect the contractor and the Government against significant fluctuations in labor or material costs or to provide for contract price adjustment in the event of changes in the contractor's established prices."[5] Therefore, it is important to note that an intentional exclusion of an EPA clause in a contract would likely preclude a recovery of increased costs in a firm-fixed-price contract.[6]

Second, an EPA clause may work against contractors when there is a decrease in costs of contract performance. In other words, because the government has the power to adjust the contract price both "upward and downward," contractors bear the risk when costs go down.
Finally, while more agencies have begun to utilize the EPA clause, there has not been much usage of the clause. There are more added steps contractors must follow to receive adjustments from the government. Thus, contractors should be more cautious reviewing the terms of the EPA clause and understand the nature of its complexities.

2. Policy Arguments

As noted above, barring the EPA clause, it is hard for contractors performing on fixed-price contracts to recover cost. In such situations, where the EPA clause is not included in the contract, federal contractors may rely on FAR Part 50, Extraordinary Contractual Relief, and ask the government for contract adjustments.

FAR Part 50 Extraordinary Contractual Relief and Public Law 85-804

Where there is no alternative basis for relief, FAR 50 provides policies for amending contracts under the extraordinary circumstances granted by Public Law 85-804. Under Public Law 85-804, or 50 U.S.C. § 1431, "[t]he President may authorize any department or agency of the Government which exercises functions in connection with the national defense, … to enter into contracts or into amendments or modifications of contracts heretofore …, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense."

Notably, the Department of Defense (DoD) is an agency with the authority to amend contracts.[7] A contractor performing on a defense firm-fixed-price contract may rely

[4] FAR 36.207 FAR 16.203-2
[5] FAR 16.203-3
[6] See Appeal of KF&S Corp., ASBCA No. 62223, 21-1 B.C.A. ¶ 37759 (Dec. 9, 2020).
[7] Executive Order 10789, https://www.archives.gov/federal-register/codification/executive-order/10789.html.

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on Public Law 85-804 and ask for amendment without consideration "to the extent necessary to avoid [actual or threatened loss] to the contractor's productive ability."[8] The agency head may establish a "contract adjustment board… to make all appropriate determinations and finding."[9] To process these findings, defense contractors may need to supply the agency with additional information, such as "how the actual or estimated dollar amount was determined and the effect of approval or denial on the contractor's profits before Federal income taxes."[10] While Public Law 85-804 does not guarantee cost adjustments, the law provides opportunities for contractors to reduce cost risks in firm-fixed-price contracts.

3. What Is on the Horizon: The Department of Defense's Updated Guidance

On May 25, 2022, DoD published a memorandum titled, "Guidance on Inflation and Economic Price Adjustments." In its original guidance on inflation, the DoD noted that "[i]n the absence of an applicable contract clause, such as an EPA clause authorizing a contract price adjustment as a result of inflation, there is no authority for providing contractual relief for unanticipated inflation under [a] [firm-fixed-price] contract."[11]

However, after receiving feedback from the Department's acquisition executives, DoD recently issued an updated memorandum titled, "Managing the Effects of Inflation with Existing Contracts," giving some hope to contractors performing on firm-fixed-price contracts. DoD said that "there may be circumstances where an accommodation can be reached by mutual agreement of the contracting parties, perhaps to address acute impacts on small business and other suppliers."[12] Moreover, DoD noted that "provided adequate consideration is obtained for the Government, such an accommodation may take the form of schedule relief or otherwise amending contractual requirements."[13] Finally, in referencing Public Law 85-804, DoD highlighted that "[w]hile the law and regulation have established stringent criteria, the Department will consider contractor requests to employ this authority…."[14]

Federal contractors may use the updated guidance as leverage to adjust contract price. To do so, contractors should prepare documents such as financial statements, evidence of steps taken to reduce losses, and a list of persons involved in the contracts.[15] In the current scheme of developing guidance on the EPA clause, we encourage contractors to continuously keep watch on policy updates and prepare necessary documents in case contractors decide to take actions.

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[8] FAR 50.103-2
[9] FAR 50.102-2
[10] FAR 50.103-4(a)(4)
[11] Office of the Under Secretary of Defense, Guidance on Inflation and Economic Price Adjustments, https://www.acq.osd.mil/dpap/policy/policyvault/USA000999-22-DPC.pdf.
[12] Office of the Under Secretary of Defense, Managing the Effects of Inflation with Existing Contracts, https://www.acq.osd.mil/dpap/policy/policyvault/USA001773-22-DPC.pdf.
[13] Id.
[14] Id.
[15] FAR 50.103-4

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