PSC PROFESSIONAL SERVICES COUNCIL
The Voice of the
Government Services Industry

February 4, 2019

Ms. Brenda Fernandez
Office of Policy, Planning and Liaison
8th Floor
U.S. Small Business Administration
409 Third Street, S.W.
Washington, D.C. 20416

Via: www.regulations.gov
Brenda.Fernandez@sba.gov

Ref: RIN: 3245-AG86; Proposed rule re: NDAAs of 2016 and 2017 and other small business government contracting

Dear Ms. Fernandez:

On behalf of the Professional Services Council (PSC),[1] I am pleased to submit the following comments on the limitations on subcontracting portion of the SBA proposed rule titled "National Defense Authorization Acts of 2016 and 2017" published in the *Federal Register* on December 4, 2018.[2] PSC has joined with other associations that comprise the Council of Defense and Space Industry Associations (CODSIA) in comments also filed today relating to provisions in this proposed rule covering a material breach of a subcontracting plan.

Introduction

We appreciate that SBA has issued this proposed rule that makes further changes and clarifications to the May 31, 2016 final SBA rule to implement section 1651 of the Fiscal Year 2013 National Defense Authorization Act[3] relating to the limitation on subcontracting. That SBA final rule became effective on June 30, 2016. We also appreciate that SBA has provided 60 days for public comments on the entire proposed rule. However, it is regrettable that it has taken more than 30 months since SBA published its final rule on May 31, 2016, to have these updates and clarifications published.

Interestingly, on the day before SBA published this proposed rule, the Department of Defense issued a class deviation on the limitation on subcontracting to make immediately effective its procedures when issuing solicitations and awarding contracts or task or delivery orders under FAR Part 19. The class

[1] PSC is the voice of the government technology and professional services industry, representing the full range and diversity of the government services sector. As a trusted industry leader on legislative and regulatory issues related to government acquisition, business and technology, PSC helps build consensus between government and industry. Our nearly 400 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social, environmental services, and more. Together, the trade association's members employ hundreds of thousands of Americans in all 50 states.
[2] Available at: https://www.govinfo.gov/content/pkg/FR-2018-12-04/pdf/2018-25506.pdf
[3] Available at: https://www.govinfo.gov/content/pkg/FR-2016-05-31/pdf/2016-12494.pdf

deviation shares many of the deficiencies that we highlight in these comments. DoD issued an updated version of this class deviation on January 8, 2019, making a change in the scope of coverage for "firms," and adding dates to all of the clauses attached to the class deviation.[4] But the result of the DoD action is to immediately put into effect for DoD contracts a limitation on subcontracting that SBA is proposing to change. PSC is preparing comments on the revised DFARS class deviation.

In addition, also on December 4, 2018, the FAR Council published a proposed rule to implement the May 2016 SBA final rule, without regard to the issues and proposed revisions included in this SBA proposed rule.[5] Of significance here is that this SBA proposed rule provides further revisions to SBA's May 31, 2016 Limitation on Subcontracting rule, including adding exceptions for certain types of solicitations and resulting awards, and seeking public comment on other aspects of the Limitation on Subcontracting practice. PSC has long advocated for the adoption of some of these exceptions and we are pleased to see them included in this SBA December 2018 proposed rule. PSC is separately submitting comments on the FAR proposed rule, including recommending that the FAR Council incorporate those exemptions into any final FAR rule.

Definition and Treatment of "Similarly Situated Entity"

While not addressed in this proposed SBA rule, each of the December 4, 2018 FAR proposed revised contract clauses for the separate small business preference programs properly provide that first tier subcontracts awarded to a "similarly situated entity" are excluded from the calculation of the 50 percent subcontract amount that cannot be exceeded; however, the clauses then provide that all work further subcontracted by such similarly situated entity does count toward the 50 percent subcontract amount that cannot be exceeded (emphasis added.) We strongly urge that this further limitation be deleted.

In fact, we encourage SBA to revisit the entire definition. This proposed rule includes important exceptions relating to to the source of work that can be included in the calculation of subcontracted work, and we support them. Furthermore, we address below in greater detail the varying interpretations relating to the "cost of materials" that directly affect the interpretation and calculation of the work that can be subcontracted, particularly for contracts for services. We also address in greater detail below the confusion caused by the treatment of "independent contractors" under the proposed FAR rule and this proposed rule. Even without these other issues, the formulation of the term "similarly situated" creates an inconsistency among small business programs and a potential administrative nightmare for prime contractors.

As to the inconsistency, under the small business goaling process, small business primes are exempt from the requirement to have a small business subcontracting plan, regardless of whether that small business prime contractor subcontracts any portion of its work to another small business or even to an "other than small business" subcontractor. Similarly, an "other than small business" prime is required to have a small business subcontracting plan but is only required to flow down the plan requirement and track awards to its first small business subcontractor. Under this proposed Limitation on Subcontracting, the small business prime contractor is required to flow down this limitation to a similarly situated entity and to ensure that the limitation is further flowed down to subcontracts awarded by that "similarly

[4] Available at: https://www.acq.osd.mil/dpap/policy/policyvault/USA000039-19-DPC_Class_Deviation_2019-O0003.pdf

[5] Available at: https://www.govinfo.gov/content/pkg/FR-2018-12-04/pdf/2018-25705.pdf

situated" small business entity. We believe such an approach adds a significant administrative burden to both the small business prime and to each small business "similarly situated" entity.

In addition, the requirement creates a further administrative challenge in tracking and determining compliance. Since there is no current subcontracting plan requirement applicable to a small business prime contractor, there is no current requirement for subcontractors of any tier to report further subcontract action to the prime (or higher tier subcontractors). Second, because the small business prime must make its representation of compliance with the 50 percent limitation on subcontracting at the time of the submission of its offer, and again at the time of the execution of its award, the prime likely has not made all of its subcontract awards or may not know – or even have reason to inquire – whether subcontractors may further subcontract work. Thus, the ability of the small business prime to comply with the limitation on subcontracting requirement is out of its control and shifts to the first tier "similarly situated entity" to whom it subcontracts.

Treatment of Independent Contractors as "Subcontractors"

The definition of the term "similarly situated entity" added in proposed FAR Part 19.001 of the December 4, 2018 FAR rule provides that a "similarly situated entity" means a "first tier subcontractor, including an independent contractor" with the same small business program status (emphasis added). This definition is repeated in full text – not merely cross-referenced – in several of the implementing clauses.

In addition, solely in the revisions to clause 52.219-14 (relating to notice of partial small business set-asides) of the FAR proposed rule, subparagraph (d) is added that provides explicitly that "(a)n independent contractor shall be considered a subcontractor." We see no reason to include subparagraph (d) in that revised FAR clause since the term is already included in the definition of the term "similarly situated," and our comments on the FAR proposed rule make that point.

More significant, however, is the confusion caused by even including the treatment of "independent contractors" in the definition of the term "similarly situated entity." As the supplemental information accompanying this proposed rule notes:

> "It appears that SBA's regulations at 13 CFR 125.6(e)(3) has caused some confusion as to how to properly treat independent contractors for purposes of the LOS provisions… (With respect to employee-based size standards), an independent contractor may be deemed an employee of the firm under the (SBA 1986) Size Policy Statement… (With respect to revenue-based size standards), an independent contractor could not be considered an employee of the firm… but would always be deemed a subcontractor."[6]

As you know, SBA's May 2016 final rule provides in 125.6(e)(3) that:

> "Work performed by an independent contractor shall be considered a subcontract and may count toward meeting the applicable limitation on subcontracting where the independent contractor qualifies as a similarly situated entity."[7]

[6] SBA 12/4/18 rule, supra, at 62519.
[7] SBA 5/31/16 final rule, supra, at 34264.

In our view, this proposed rule adds further confusion rather than clarity to this increasingly common situation where an individual who is an "independent contractors" may simultaneously be considered an "employee" of a contractor. To avoid further confusion, we recommended that the FAR Council delete the phrase "independent contractor" from every FAR definition of a "similarly situated entity."

Excluding the Cost of Materials

In applying the limitation on subcontracting to the various types of acquisitions, the SBA May 2016 final rule and the December 2018 FAR proposed rule provide an explicit exemption from the calculation of the limitation on subcontracting for "the cost of materials" for solicitations and awards for supplies, for general construction, and for special trade construction – but not for solicitations and awards for services. Nevertheless, we strongly urge SBA, as we did the FAR Council in our comments, to add the exemption for "the cost of materials" in services contracts. Services contractors must acquire "materials" in the performance of their work as well as construction contractors. In construction contracts, material may be the actual construction material (e.g. cement, bricks, plumbing supplies, etc.) but not the labor for performing the work; for services contracts, "material" may include airline tickets and hotel rooms in support of business travel, and vehicles and office equipment used for program support and international development assistance.

In the supplemental information accompanying the May 2016 SBA final rule regarding this topic, SBA noted that:

> "As discussed below, because the limitations on subcontracting for a service contract apply only to the services portion of the contract, any 'cost of material' would not be part of the services to be provided through the contract and, thus, would be excluded from the limitations on subcontracting analysis on that basis."[8]

SBA's supplemental information further provides that:

> "As noted above, SBA believes that only the services portions of a requirement identified as a service requirement are considered in determining compliance with the limitation on subcontracting requirements... However, all costs associated with providing the service, including any overhead or indirect costs associated with those services, must be included in determining compliance."[9]

However, this "interpretation" has not been included in the text of the SBA regulations or the FAR proposed rule. Nor is it included in the supplemental information accompanying the FAR proposed rule. In fact, its absence from the coverage of services while being explicitly covered under other types of contracts is already causing confusion for both agencies and for small businesses.

We welcome the addition included in this proposed rule to section 125.6(a)(1) that:

> "other direct costs may be excluded to the extent they are not the principal purpose of the acquisition and small business concerns do not provide the service, such as airline travel, work

[8] SBA 5/31/16 final rule, supra, at 34245.
[9] Id

> performed by a transportation or disposal entity under a contract assigned the environmental remediation NAICS code (562910), cloud computing services or mass media purchases."

PSC has been among those advocating for the exclusion of certain costs – not just direct costs – for airline travel and similar expenses. We strongly recommend that SBA delete the word "direct" from the addition to 125.6(a)(1) because all such costs incurred in supporting contract performance, regardless of how the contractor characterizes them for its accounting and billing purposes, should be excluded from the LOS restriction. In addition, we encourage SBA, as we did the FAR Council, to add the explicit exclusion for the cost of materials to the coverage for services contracts and support SBA retaining this clarification in its revisions to section 125.6. At a minimum, we urged the FAR Council to include SBA's explanatory statement in the supplemental information accompanying any final FAR rule.

Information Regarding LOS Compliance

In the supplemental information to this proposed rule, SBA is seeking comments on new proposed section 125.6(e)(4) that provides authority for the contracting officer to require the contractor to demonstrate its compliance with the LOS requirements if the information regarding such compliance is not already available to the contracting officer.

The lead-in language in current section 125.6(e), added by the May 2016 SBA final rule, provides that in determining compliance with the applicable LOS:

> "The period of time used to determine compliance for a total or partial set-aside contract will be the base term and then each subsequent option period. For an order set aside under a full and open contract or a full and open contract with reserve, the agency will use the period of performance for each order to determine compliance unless the order is competed among small and other-than-small businesses (in which case the subcontracting limitations will not apply)."

The clauses proposed in the FAR December 2018 proposed rule provide that the LOS will be included in solicitations for covered contracts and that, by submitting an offer, the offeror agrees that it will comply with the LOS requirement. As such, compliance with the LOS requirements is treated as an element of responsiveness to a solicitation and not a matter of contractor responsibility. We strongly support that formulation.

Thus, we recommend that information on compliance with the LOS provisions be collected from the small business prime no more frequently than once during the base period – and then only closer to the end of the base period and in sufficient time for the contracting officer to be assured of the contractor's compliance and to use that information in conjunction with the determination to exercise the first option period. For each subsequent option period, the information on the contractor's compliance with the LOS provision should be obtained only closer to the end of each option period and in sufficient time for the contracting officer to be assured of the contractor's compliance with the LSO provision during the option period and to use that information in conjunction with the determination to exercise the next option period.

Exclusions from the LOS

The supplemental information describing SBA's intent in creating exceptions to the LOS requirement was helpful, and PSC supports including all of the listed exceptions in any final rule. However, with

respect to the exclusion relating to contracts for work performed overseas, the supplemental information justifies a more expansive exclusion than the text of the rule actually provides. The exclusion under revised 125.6(a)(1) states only that "work performed by an independent contractor under a contract that was awarded pursuant to the Foreign Assistance Act of 1961 (and) may also be excluded." In our view, first, all work performed outside the United States that must use non-U.S. local individuals or organizations should be excluded from the LOS requirements. Second, some, but not all, work awarded by the U.S. Government that is to be performed outside the U.S. that must use non-U.S. local individuals or organizations is awarded under the Foreign Assistance Act; while we do not have a better formulation at this time, we are working with our members to develop an alternative and look forward to working with SBA, USAID and others on the development of an appropriate exemption. Finally, the proposed rule is discretionary as to whether the exclusion is applicable; in our view, work covered by the exclusion SHALL BE exempt from the application of the LOS requirements.

Conclusion

Thank you for the opportunity to provide these comments. If PSC or I can be of any further assistance, please do not hesitate to let me know. I can be reached at (703) 875-8148 or at chvotkin@pscouncil.org.

Sincerely,

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Executive Vice President and Counsel