

The Small Business Administration Changes the Time at Which a Contractor Must Certify its Status as a Small Business Concern

On November 15, 2006, the Small Business Administration (“SBA”) issued a final rule 71 Fed. Reg. 66434-66444 will change the time at which government contractors must certify their status as small businesses. Effective June 30, 2007, the new rule applies to long-term government contracts, meaning “contracts with durations greater than five years (including options), including all existing long-term contracts, Multiple Award Schedule (‘MAS’) Contracts, Multiple Agency Contracts (‘MACs’) and Government-wide Acquisition Contracts (‘GWACs’).” Further, this rule will apply whenever a small business contract is novated, or when a company contracting as a small business is acquired or merges. This update summarizes the SBA’s new rules, comments on the rules’ implications, and offers some practitioners’ tips.

Background:

In the past, contractors that certified they were “small” at the time of award could retain the benefits of being small businesses throughout the life of their long-term contracts, regardless of how large they grew after award, even if they were acquired by much larger companies. Similarly, as long as contractors were small when their contracts were awarded, agencies could continue to order from these contracts and count contractors as small in calculating progress toward meeting their small business goals, regardless of the contractors’ size or corporate status after award. The impact of this loophole on small business competitors was magnified in long-term contracts such as MAS, MACS, and GWACs, which often last for well over ten years. The General Services Administration (“GSA”) addressed this loophole in 2003 by requiring contractors with Federal Supply Service MAS contracts and other multiple award type contracts awarded under FAR Part 16 that contain option periods to re-certify their size status prior to the government exercising an option period. GSA Acquisition Letter MV-03-01, “Federal Acquisition Regulation Class Deviation—Size of Business Representation” (Feb. 21, 2003) (available online at http://www.gsa.gov/gsa/cm_attachments/GSA_DOCUMENT/MV-03-01_R22P56_0Z5RDZ-i34K-pR.doc).

The SBA’s Final Rule:

The SBA’s new rule now requires re-certification of size status at the following times:

- Within thirty (30) days of an approved contract novation; or
- Within thirty (30) days of the finalization of a merger or acquisition where novation is not required.

Further, the SBA’s new rule requires a contracting officer to request size recertification at the following times:

- One hundred and twenty (120) days prior to the end of the fifth year of a long-term, MAS, MAC, or GWAC; and

- After the fifth year of a long-term contract, one hundred and twenty (120) days prior to the exercise of any option under a MAS, MAC or GWAC.

If the business cannot certify its status as “small,” the SBA’s new rule requires the business to notify the government that its status has changed to “other than small.” While the contractor would still be eligible for work under existing contract, the procuring agency can no longer count any options or orders from that contract towards its small business contracting goals, thereby making procurement from such a business potentially less attractive to the government.

Even where a contractor continues to receive work from the agency, it must ensure that it is able to perform the contract as a large business. If contract award was based on full and open competition, a large contractor should be able to perform. If, however, a contractor receives a small-business set-aside, the contractor will not be able to meet the limitations on subcontracting at 13 C.F.R. § 125.6. The preamble to the final rule cautions that:

- A contractor that is awarded a contract as a result of a small business set-aside must comply with the applicable performance requirements throughout the life of the contract, even if the concern grows to be large. Thus, on a long-term, small business set-aside contract where a concern cannot certify that it is small and the procuring agency exercises the option, the concern will still have to comply with the performance requirements that are applicable to all contract holders. 71 Fed. Reg. at 66437.

Practical Implications:

The SBA’s new rule provides several new pitfalls of which both small businesses and “other than small” business contractors who have or will acquire a small business must be aware:

- Small business contractors operating under long-term MAS, MACs or GWACs must recertify or update their size status five years after the award of such a contract, as well as any time before the exercise of any option period thereafter. This new administrative burden may involve significant compliance-related expenditures, and may have the effect of catching small business owners off-guard, thereby losing orders they would have normally received under the old rule.
- Large businesses examining acquisition of a small business because of a government contract should examine the circumstances under which the contract was awarded to ensure that the large business will be able to meet the performance requirements of the contract related to size, such as the limitation on subcontracting.
- Businesses that anticipate a loss of business once their re-certifications become due may avoid the growth of revenue and staff that the SBA is designed to foster to retain their small business status.
- Small business owners seeking to exit the business may find it more difficult to find large businesses to buy them out, especially where the government is a significant customer. Such owners may want to consider an employee stock ownership plan.
- Business combinations become significantly more risky, as each transaction carries the potential that the resulting business is suddenly “other than small,” thereby imposing a 30 day deadline for reporting such change.

- Failure to meet one's reporting obligations, or making a false certification could potentially lead to the adverse consequences including contract termination, suspension or debarment; or civil or criminal liability under the False Claims Act.

Practitioners' Tips:

The new rule significantly changes the landscape both for small business contractors and any business involved in a merger or acquisition of a government contractor. The following practitioners' tips should go a long way toward avoiding the adverse consequences mentioned above.

Small Business Contractors

- To the extent you rely on orders placed on MAS, MACs or GWACs, closely monitor the size of your business. At some point in the growth of your company, you may need to make a decision on whether a loss in orders from such a contract justifies the continued expansion of your enterprise.
- If you are involved in a merger or acquisition, immediately notify all responsible parties that a new certification or disclosure is due shortly after the deal is closed.

Companies Acquiring Government Contractors

- As part of your due diligence, investigate whether the company you are acquiring is performing any federal government contracts as a small business. If so, be sure to make the required disclosure. So that this issue does not get lost during the hectic post-merger or acquisition paper frenzy, be sure to address this requirement at closing. Also, be sure to consider the impact of the loss of "small business" status on the value of the company.

Companies Who Acquired Government Contractors Who Certified As Small Businesses

- If you are a large business who has acquired other businesses, review MAS, MACs or GWACs contracts from predecessor organizations to determine if any of them were awarded under certifications that represented the predecessor entity as small. If so, and the award was unrestricted, you may have a reporting obligation. If so and the award was set-aside for small business, you might be violating performance obligations.

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