

## Comments Show Need For Clarity On SBA Proposed Rule

By **Scott Freling, Peter Terenzio and Daniel Raddenbach** (October 24, 2024, 4:29 PM EDT)

The Small Business Administration recently issued a proposed rule<sup>[1]</sup> that would significantly change the rules concerning small business recertification in M&A transactions and other events.

The SBA has framed the proposed rule, issued Aug. 23, as a consolidation of what is currently a scattered set of regulations, but the rule goes further than consolidating and clarifying existing law.

It would expand recertification requirements in several key ways, including eliminating exemptions that currently allow contractors to continue to utilize set-aside multiple award vehicles after a disqualifying recertification — i.e., a recertification as other than small or other than disadvantaged.

The SBA invited public comment on the proposed rule. The comments were due by Oct. 7. We have spent some time reviewing the comments submitted, which provide insight into the issues that affect both small business contractors and the industry writ large.

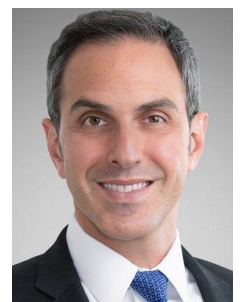
As discussed below, many of the comments describe the potential chilling effects of the proposed rule, which could deprive contractors of key income streams just as they graduate from small business status and discourage investors and other contractors from acquiring small businesses that hold multiple award contracts.

The sections below describe the proposed rule in greater detail and provide an overview of the comments to the proposed rule.

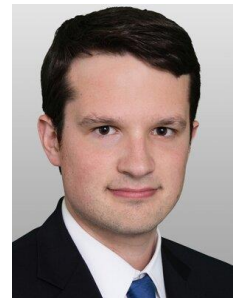
### Overview of the Proposed Rule

At present, recertification requirements are scattered across the SBA regulations in various iterations that are specific to different socioeconomic programs — e.g., the Women-Owned Small Business program and the Service-Disabled Veteran-Owned Small Business program.

The proposed rule attempts to streamline this with a new Section 125.12 in Title 13 of the Code of Federal Regulations. The new section would consolidate the recertification requirements across all socioeconomic programs and describe the circumstances under which recertification is required.



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Section 125.12(a) would require contractors to recertify their size and small business program status within 30 calendar days of a novation, merger, acquisition or sale which results in a change in controlling interest.[2] Notably, an "agreement in principle" would be sufficient to trigger the recertification requirement.[3]

In other words, small businesses would be required to recertify their size and status prior to the consummation of the actual transaction triggering the recertification. This represents a major change to the existing rules.

Consistent with existing rules, Section 125.12(b) would provide a process for recertifying long-term awards within 120 days of the end of the fifth year of the contract.[4]

Also consistent with existing rules, Section 125.12(c) would provide that recertification is required where requested by a contracting officer in relation to a particular solicitation.[5]

Additionally, the proposed rule clarifies that a joint venture is entitled to recertify as small provided that all parties to the joint venture qualify as small, or where the protégé in a still active mentor-protégé joint venture qualifies as small at the time of recertification.[6]

The proposed rule goes further than the existing recertification rules by expanding the effects of disqualifying recertifications on contractors' eligibility for new set-aside work.

#### ***Effect of Disqualifying Recertification on Existing Multiple Award Vehicles***

Under the current rules, contractors that hold multiple award vehicles that were set aside for small or disadvantaged businesses generally remain eligible for new orders under those awards even after a disqualifying recertification.

The proposed rule would eliminate this: It flatly states that a disqualifying recertification "renders a concern ineligible for future set-aside or reserved awards, including awards of set-aside or reserved orders against pre-existing unrestricted or set-aside multiple award contracts".[7]

Essentially, following a disqualifying recertification, the contractor would remain eligible for non- set-aside orders issued under multiple award vehicles, as well as orders issued under single award set-asides, but would not be eligible for set-aside orders under a multiple award vehicle, including a set-aside multiple award vehicle.

Notably, this restriction also would apply to set-aside orders placed against Federal Supply Schedule, or FSS, contracts.

Currently, the U.S. Government Accountability Office and the SBA Office of Hearing and Appeals precedent provides that a contractor's eligibility for a set-aside order placed against an FSS contract is determined based on the contractor's status as of the date of its offer for the FSS contract, and not the date of the order placed against the FSS contract.[8]

The proposed rule would eliminate this exception for FSS contracts, and instead apply the same general rule described above.[9]

### ***Effect of a Disqualifying Recertification on Options to Extend Certain Contracts***

Under the proposed rule, after a disqualifying recertification, a contractor would remain eligible for options on its existing single award set-asides but would not be eligible to receive options on its existing multiple award set-asides.[10]

### ***Effect of a Disqualifying Recertification on Pending Awards***

The proposed rule provides that if events triggering a disqualifying recertification under Section 125.12(a) occur more than 180 days after the date of an offer for a set-aside award, but before award, the contractor remains eligible for the award.[11]

However, the proposed rule also provides that this exception does not apply if the award is being issued under a multiple award set-aside vehicle, because the contractor "would not be eligible for orders set aside for small business or set aside for a specific type of small business."[12]

### ***Effect of a Contracting Officer Request***

The proposed rule provides that "[i]f a concern has a disqualifying recertification in response to a contracting officer request for recertification on a specific order or agreement, the concern is ineligible for the specific order or agreement but remains eligible for other set aside or reserved awards and unrestricted awards." [13]

The SBA describes the proposed rule's recertification requirements as primarily a "clarification" to reflect how the SBA "always intended recertification to operate, but which may be unclear from the existing regulatory text." [14]

It is clear, however, that the proposed rule introduces potentially significant new restrictions, which in some instances represent an evolution to the SBA's prior positions.

For example, in October 2020, the SBA published a final rule in which it explained that it had intentionally shielded FSS contracts from recertification requirements in order to avoid "unnecessary risk to a program currently yielding good results for small business." [15]

In the proposed rule, however, the SBA clarifies that the FSS exception does not apply "when any trigger for size recertification occurs under [Section] 125.12." [16]

A number of comments to the proposed rule noted the inconsistency, arguing that what the SBA describes as clarifications are actually significant changes to the existing recertification framework on which small businesses have long relied.

As discussed in the next section, many commenters expressed concern about the impact of these changes.

### **Comments to the Proposed Rule**

As of Oct. 17, the SBA has received 319 comments, [17] of which 253 have been made public. These comments by and large expressed concern regarding potential chilling effects on small business M&A activity, as well as the ability of small business contractors to scale effectively without being able to fully

utilize their existing multiple award set-aside contracts. Several key themes in this vein include the following.

***Commenters and the SBA need more time to consider ramifications.***

Several commenters, including Sen. Joni Ernst, R-Iowa, ranking member of the Senate Committee on Small Business and Entrepreneurship and the American Bar Association Section of Public Contract Law, urged the SBA to extend the comment period for the proposed rule to give stakeholders more time to digest the proposed rule and ensure that the SBA has thoroughly considered the ramifications. Ernst specifically requested the SBA to issue a 60-day extension.

***The proposed rule would dampen critical activity.***

Many public comments expressed that the proposed rule would limit the valuation of small businesses that hold multiple award set-aside contracts, thereby reducing the businesses' attractiveness as M&A targets.

These commenters highlighted the benefit of M&A investment in small business contractors, including that it can allow contractors to scale their capabilities, thereby strengthening the industrial base.

Commenters expressed specific concern that private equity investors, which have helped fuel the growth and development of the government contracts industry, could move away from small- to mid-size companies, leaving them to try to scale through organic growth alone.

***The proposed rule could penalize small businesses for scaling.***

Many commenters expressed that the recertification rules would make it more difficult for small businesses to scale effectively by cutting off access to new work under their lucrative multiple award set-aside contracts after recertification.

Commenters described that the rule would effectively punish businesses for scaling effectively by cutting off access to task orders and options under the contracts that allowed them to graduate from small business status in the first place.

Further, even as these contractors would lose access to future opportunities under these contracts, they also would be required to compete in the open market against established firms many times their size.

Commenters argued that the risks created by the proposed rule run contrary to the SBA's mission of supporting small business.

A few commenters offered suggestions to mitigate the recertification rules, such as by implementing a phased implementation for the rule to give businesses time to adapt, or creating exemptions from the eligibility restrictions for companies that are no longer considered small following recertification, but nevertheless remain below a certain size threshold.

***The proposed rule undermines GAO and Office of Hearing and Appeals authority.***

One commenter noted that by changing the recertification rules in order to, in the SBA's words, "overcome several recent decisions" from the GAO and the Office of Hearing and Appeals, the SBA has

made it harder for contractors to rely on legal outcomes from those authorities

The commenter argued that it is harmful when the SBA speaks with multiple and contradictory voices on recertification rules, which businesses rely on when making long-term business planning decisions.

***Consolidation of SBA recertification rules may have unintended consequences.***

Several commenters appreciated the SBA's move to consolidate the recertification rules under one section, but cautioned that the SBA should more thoroughly consider whether different socioeconomic programs warrant different treatment under the recertification rules.

***The SBA should retain a recertification exemption for FSS contracts.***

Several commenters argued against removing the exemption allowing holders of GSA FSS contracts to continue to receive set-aside orders after recertification, citing the distinct features of the FSS program and the critical importance of FSS contracts to firms that are transitioning to mid-size scale.

***Contractors need clarity on agreements in principle.***

Several commenters noted that the proposed rule does not define agreements in principle, which trigger recertification under Section 125.12(a) of the proposed rule. This would leave contractors with the task of having to wade through a host of fact-specific Office of Hearing and Appeals precedent to determine whether and when they have reached an agreement in principle.

The commenters argued that the ambiguity risks creating significant confusion both for contractors and contracting officers and that it ignores the realities of M&A transactions, which often take significant time to materialize.

Moreover, the proposed rule does not consider the potential consequences if a contractor were to recertify its status after an agreement in principle, but before the final date of the transaction, but the transaction then falls through, leaving the contractor with an incorrect size and status representation.

It should be noted that in addition to comments expressing concern about the new recertification requirements, a few commenters expressed support for the recertification rules, citing instances where large businesses that take advantage of exemptions allowing them to retain the benefit of existing set-asides continue to garner significant ongoing set-aside work that was intended for small businesses.

Commenters also argued that the proposed rule's clarifications to the recertification requirements would increase consistency and transparency regarding the effects of M&A transactions and would help both contracting agencies and businesses better understand eligibility status following recertification.

**Nex Steps for the Proposed Rule**

The SBA's small business eligibility and recertification regulations are notoriously difficult to parse, despite the fact that they are designed to be used by small businesses that may lack regulatory sophistication or resources needed to unpack the complexity.

While the proposed rule lends some much-needed clarity to the rules governing size and status

recertification, many commenters have observed shortcomings that the SBA should address as it moves forward with this rulemaking.

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[1] 89 Fed. Reg. 68,274 (Aug. 23, 2024), <https://www.federalregister.gov/documents/2024/08/23/2024-18325/hubzone-program-updates-and-clarifications-and-clarifications-to-other-small-business-programs> [hereinafter, "Proposed Rule"].

[2] Id. at 68,305.

[3] Id.

[4] Id.

[5] Id.

[6] Id. at 68,306.

[7] Id. at 68,285.

[8] See Washington Business Dynamics LLC, B-421953, B-421953.2, Dec. 18, 2023, 2023 CPD 286 at 8 (noting that size recertification requirements do not apply to "orders or [blanket purchase agreements] issued under any FSS contract"); Size Appeal of: Oxford Government Consulting LLC, Appellant Re: Micro Systems Consultants Inc., SBA No. SIZ-5732, 2016 WL 4990545, at \*2 (Apr. 21, 2016) ("SBA regulations do not require a concern to have its size determined at the time it submits an offer under a [blanket purchase agreement] arising out of an FSS.").

[9] Proposed Rule at 68,276 ("If there is a disqualifying size recertification in response to any event in 125.12, including a merger, sale, or acquisition, the concern must notify the contracting officer for the underlying multiple award contract and the contracting officer for all existing orders, and update its SAM.gov profile to reflect its current size status. The concern is no longer eligible for set-aside orders or agreements against the FSS MAS.>").

[10] Id. at 68,305-06.

[11] Id. at 68,305.

[12] Id.

[13] Id.

[14] Id. at 68,285.

[15] 85 Fed. Reg. 66,146, 66,152 (Oct. 16, 2020), <https://www.govinfo.gov/content/pkg/FR-2020-10-16/pdf/2020-19428.pdf>.

[16] Proposed Rule at 68,276.

[17] <https://www.regulations.gov/docket/SBA-2024-0007>.