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**VIA FEDERAL ERULEMAKING PORTAL**

Brenda Fernandez
Office of Policy, Planning, and Liaison
U.S. Small Business Administration
409 Third Street, SW, 8th Floor
Washington, DC 20416

Re: RIN: 3245-AG71, Comments on U.S. Small Business Administration Proposed Rule – Credit for Lower Tier Small Business Subcontracting

Dear Ms. Fernandez:

We are writing to submit comments on the above-referenced Proposed Rule, issued October 6, 2015, 80 Fed. Reg. 60,300, to amend the U.S. Small Business Administration's ("SBA") regulations pertaining to small business subcontracting. Our firm represents a wide variety of firms operating across the government contracting spectrum. The intent of the Proposed Rule is to implement Section 1614 of the National Defense Authorization Act for Fiscal Year 2014. The relevant provisions of Section 1614 call for prime contractors with individual subcontracting plans to receive goaling credit for small business subcontractors performing at any tier, not just for the first tier subcontractors. While we believe many of the proposals are positive and will assist both large and small businesses working with subcontracting plans, we believe that there are several aspects of the Proposed Rule that could be amended to provide greater clarity and less burdensome outcomes for contractors administering subcontracting plans, particularly contractors that maintain commercial plans.

- **Allowing goaling credit under single contract subcontracting plans for small business subcontracts awarded at any tier**

Generally, we are in favor of the notion of counting lower tier subcontracts towards the satisfaction of a prime contractor's subcontracting plan, because it will make it easier for prime contractors to satisfy their plans and small businesses will have the opportunity to be further involved in contract performance. However, the Proposed Rule may have the unintended consequence of dis-incentivizing prime contractors from making every effort to award first tier subcontracts to small businesses.

We appreciate that SBA is implementing a statutory directive mandating that prime contractors should receive goaling credit for subcontracts awarded at any tier. However, we

have heard concerns from the small business community that the Proposed Rule may dis-incentivize large business prime contractors from issuing first tier subcontracts to small businesses, since these primes may now rely on subcontracts made at any tier to receive credit towards their goals. We understand from industry that the profitability of subcontracts awarded to small businesses reduces significantly with each level below the prime contract award. In addition, the experience small business contractors stand to gain is likewise diminished for each level of removal from the prime award. Thus, if prime contractors are not incentivized to issue direct subcontracts to the small business community, the Proposed Rule may have the unintended consequence of eroding small businesses' profitability and experience stemming from their subcontract participation.

SBA could mitigate this issue if the rule is revised to require firms to state, in their subcontracting plan, a separate lower-tier subcontracting goal if the firm intends to utilize lower-tier subcontractors. For example, if a prime contractor has a goal of 3% spending on HUBZone firms, and it intends to take credit for lower-tier subcontracts, the firm should state in its plan a goal for how much of the 3% will be spent on first-tier HUBZone subcontractors and how much will be spent on lower-tier HUBZone subcontractors. While prime contractors should be permitted to take credit for lower-tier subcontracts to small businesses, this should not be at the complete expense of awarding more profitable and substantive first tier subcontracts to small businesses.

We also believe that the Proposed Rule could benefit from additional points of clarity. First, the Agency should make clear in the preamble to the final rule that taking credit for lower-tier subcontractors pertains only to subcontracting plans and does not extend to agencies' prime contract set-aside goals. We have heard from some in the industry who fear that agencies will conflate this new rule with their prime contract spending goals and will believe they can take credit toward their prime contract spending goals based on lower-tier subcontracts awarded to small businesses under subcontracting plans.

In addition, the proposed language of 13 C.F.R. § 125.3(a)(1)(i)(C) emphasizes that the subcontracting dollars may only be reported once "for the same award," but then states that any particular small business subcontract "may be reported under more than one subcontracting plan." 80 Fed. Reg. at 60,302. We believe the phrasing of this rule may prove problematic in its practical application. For example, a large business prime contractor could have a large business subcontractor, who in turn has a made a lower-tier subcontract to a small business. In mandating that the subcontracting dollars may only be reported once "for the same award," the Proposed Rule creates confusion regarding whether both the large business prime contractor and large business subcontractor are able to take credit under their respective small business subcontracting plans for the same small business subcontract awarded by the large business subcontractor. We suggest modifying the language of the Proposed Rule as follows: "The actual subcontracting dollars are only reported once by one contractor for the same award to avoid

double counting the dollars, nothwithstanding the fact that a small business subcontract may be reported under more than one subcontracting plan." (Modification to Proposed Rule emphasized.)

We also believe that SBA should provide practical examples of how such subcontract awards will be reported and counted. SBA's concern is to prevent double and triple counting of small business subcontracting awards under each individual subcontracting plan goaling categories. For example, a $500,000 subcontract award made to a Woman-Owned Small Business ("WOSB") may be reported under a contractor's goals for awards made to both small businesses and WOSBs. We believe the following examples may be helpful and alleviate confusion as contractors seek to accurately report their subcontract awards:

> *Large business A has received a prime contract award valued at $1 million. A subcontracts $500,000 to small business B. B then issues a $250,000 subcontract to C, a WOSB. A can report a total of $500,000 towards its small business subcontracting goal, and $250,000 towards its WOSB subcontracting goal. A cannot double count the awards to B and C as $750,000 subcontracted to small businesses.*
>
> *Large business X has received a prime contract award valued at $1 million. X subcontracts $500,000 to large business Y. Y then issues a $250,000 subcontract to Z, a small business. Both X and Y may each take credit for $250,000 towards their small business subcontracting goals.*

- **Clarification of requirements for individual versus commercial plans**

The Proposed Rule begins by distinguishing the requirements for individual versus commercial plans. For example, the preamble is clear that the mandates of Section 1614 apply "only when determining whether or not a prime contractor has met its individual subcontracting plan goals," and does not apply "where the prime contractor has a commercial plan or comprehensive subcontracting plan." 80 Fed. Reg. 60,301 (emphasis added). While the language of the Proposed Rule is clear that the subcontract goaling changes are applicable only to holders of individual plans, we believe that the Proposed Rule should be revised to clarify that the new burdensome monitoring and reporting requirements implemented by Section 1614 are also only applicable to individual plans.

The Proposed Rule's preamble recognizes that the enhanced monitoring and reporting requirements as provided in Section 1614 are only applicable for individual plans:

> Section 1614 further provides that where a prime contractor or subcontractor is required to have an individual subcontracting plan, the prime contractor or the subcontractor will review and approve subcontracting plans submitted by their subcontractors, monitor their subcontractors' compliance with the subcontracting plans, ensure that reports are submitted by their subcontractors, acknowledge receipt of subcontractors' reports, monitor subcontractor performance, and discuss subcontractor performance with subcontractors where necessary.

Id. In addition, increased emphasis is also placed on the recitation of the types of records the prime contractor will be required to maintain to demonstrate that it has adopted procedures to ensure that subcontractors at all tiers will comply with the requirements and goals of their subcontracting plans.

These revised monitoring provisions are robust, and will require a significant amount of time and diligence from the prime contractors. Therefore, we believe it is important that the language of the Proposed Rule be revised so that Section 1614's monitoring requirements are applicable only to individual plans, not commercial plans, as the statute intended. For example, the proposed subsection (x) of 13 C.F.R. § 125.3, which implements the heightened monitoring requirements, does not currently indicate that its requirements are only applicable to individual plan holders.

The distinction between individual plans and commercial plans is important, and should not be obscured. As a main point of difference, commercial plan holders are not required to flow down subcontracting plan requirements to subcontractors. Currently, subsection (x) mandates that prime contractors "must require all subcontractors" to adopt subcontracting plans. The enhanced monitoring requirements have been embedded here. It is important that SBA reiterate that holders of commercial plans are not required to flow down subcontracting plan requirements.

FAR 52.219-9(j) provides two potential exceptions to the requirement to flow down the subcontracting plan requirements to subcontractors: (1) when the prime contract contains FAR 52.212-5 or (2) when a subcontractor provides a commercial item subject to FAR 52.244-6 under a prime contract. The first exception is based on the nature of the prime contract and the second exception is based on the nature of the subcontract, and these are either/or exceptions.

FAR 52.212-5(e)(1) lists the few FAR clauses that should be flowed down in a subcontract for commercial items. FAR 52.219-9 is not one of the required flow-down clauses listed in FAR 52.212-5(e)(1). There is nothing in FAR 52.212-5 to indicate FAR 52.219-9 must be flowed down to subcontractors in any circumstance. FAR 52.219-9(j) is the only clause to

address flow down of the subcontracting plan requirement, and that clause explicitly states that the subcontracting plan requirement is not flowed down to subcontractors when the prime contract contains FAR 52.212-5.

The FAR Councils have previously addressed this and found that FAR 52.212-5(e) and FAR 52.219-9(j) are not in conflict. In FAR Case 2005-040, a commenter questioned the need to add the language now found in FAR 52.219-9(j), which states that subcontracting plans are not required from subcontractors when the prime contract contains FAR 52.212-5. The commenter objected to the proposed language because the commenter believed that FAR 52.219-9 should be included in contracts for commercial items. In response, the FAR Councils rejected the comment and kept the flow-down exception in FAR 52.219-9(j) because, according to the FAR Councils, the language in FAR 52.219-9(j) "is consistent with FAR 52.212-5(e)(1)." 75 Fed. Reg. 34,260, 34,261 (June 16, 2010) (emphasis added).

The consistency the FAR Councils noted in FAR 52.212-5(e)(1) and FAR 52.219-9(j) is that when an acquisition is for commercial items, whether at the prime contract or subcontract level, subcontractors are exempted from the subcontracting plan requirements in FAR 52.219-9. Similarly, for both of the flow-down exceptions in FAR 52.219-9(j), the common thread is the commercial nature of the acquisition.[1] As long as either the prime contract (FAR 52.212-5) or the subcontract (FAR 52.244-6) is for commercial items, FAR 52.219-9(j) indicates that subcontractors are not required to have subcontracting plans.

It makes sense not to flow down the subcontracting plan requirement in commercial item acquisitions because of the Congressional policy, embodied in 41 U.S.C. § 3307 and FAR Part 12, that such acquisitions should be simplified and contain as few FAR clauses as possible. See FAR 12.301(a) (citing 41 U.S.C. § 3307 and stating that, to the maximum extent practicable, contracts for commercial items should contain only those FAR clauses required by law or that are consistent with customary commercial practice); see also FAR 12.102(c) (stating that when a policy in another part of the FAR is inconsistent with a policy in FAR Part 12, Part 12 takes precedence for the acquisition of commercial items).

The exclusion of the flow-down requirement from commercial item acquisitions is also consistent with the Small Business Act. The Small Business Act requires a subcontracting plan to contain:

[1] The inclusion of FAR 52.212-5 in a prime contract signals the acquisition is for commercial items. See FAR 12.301(b)(4) (instructing that FAR 52.212-5 should be inserted in acquisitions for commercial items). Conversely, FAR 52.244-6 applies when the prime contract is not for commercial items, but the subcontract is. See FAR 44.403 (instructing that FAR 52.244-6 should be included in solicitations and contracts "other than those for commercial items.").

> [A]ssurances . . . that the offeror or bidder will require all subcontractors (except small business concerns) who receive subcontracts in excess of $1,000,000 in the case of a contract for the construction of any public facility, or in excess of $500,000 in the case of all other contracts, to adopt a plan similar to the plan required under paragraph (4) or (5) . . .

15 U.S.C. § 637(d)(6)(D) (emphasis added). Based on the statute's separate uses of the terms "subcontract" and "contract," and the way the statute ties the receipt of a subcontract to a contract, we believe Congress envisioned that a prime contractor would be required to flow down the subcontracting plan requirement to subcontractors that work directly under a particular federal prime contract, such as in the case of a subcontract issued in connection with a federal prime contract for construction of a public facility.

When a prime contractor has an individual subcontracting plan related to a specific federal prime contract, it is reasonable that large subcontractors working underneath that federal project would also need to implement their own subcontracting plan to ensure the small business participation goals for that project are met. However, when a contractor has a commercial plan, the prime contractor does not have subcontracting goals or subcontracts tied to a particular federal project. See FAR 52.219-9(g) (indicating a commercial plan relates to all of the prime contractor's purchasing, both commercial and government). Indeed, many contractors with commercial plans have thousands of suppliers that, by and large, do no commercial work. It is for reasons like these that we believe Congress envisioned a prime contractor would need to require a subcontractor to have its own subcontracting plan in connection with a specific federal prime contract, but not, as noted in FAR 52.219-9(j), when the prime contract or subcontract is an acquisition for commercial items.

We bring this up because, despite what we believe is clear in the FAR and in the FAR Councils' previous comments on the flow-down issue, we have seen some agencies interpret the FAR as requiring prime contractors with commercial plans to flow down the subcontracting plan requirements if the subcontractor is not providing a commercial item. We believe the correct interpretation of FAR 52.219-9(j) is that flow-down is not required if the prime contract is for commercial items, regardless of the nature of the subcontracts. Therefore, we believe it is critical that SBA amend the proposed 13 C.F.R. § 125.3(x) to clarify that the enhanced monitoring requirements do not apply to holders of commercial plans, as the statute intended.

- **Requiring prime contractors to list North American Industry Classification System (NAICS) codes for each subcontract solicitation**

We disagree with the proposed change to 13 C.F.R. § 125.3(v) that would require contractors to list the NAICS code and size standard for each subcontract solicitation. Again, we

believe that SBA should amend the language of the Proposed Rule to clarify that this requirement does not apply to commercial plans because the statute only directed this with respect to individual plans.

Also, in its current form, the Proposed Rule says that "[t]he contractor must assign to the solicitation and the resulting subcontract the NAICS code and corresponding size standard that best describes the principal purpose of the subcontract." The final rule should be amended to make clear that this requirement applies only for subcontracts under individual subcontracting plans, and only when a solicitation is utilized. We do not believe SBA intends to suggest that contractors must utilize solicitations for subcontracts. Many, if not most, subcontracts are issued without formal solicitations.

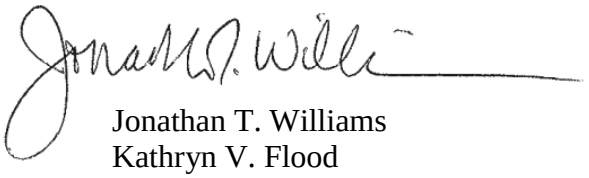
The proposed requirement at 13 C.F.R. § 125.3(v) is particularly troublesome for firms with commercial subcontracting plans. Most firms that have commercial plans have thousands of vendors, and many times that number of invoices and purchase orders issued each year. It is not practical for these firms to issue a solicitation for every subcontract, let alone assign each of these solicitations a corresponding NAICS code. For this reason, we believe the Proposed Rule does not provide for a critical exemption for commercial plans which should be added in the final rule.

- **Permitting reliance on SAM representations**

We also note that it is a positive development to allow (but not require) prime contractors to accept a subcontractor's size and representations in the System for Award Management ("SAM) if they represent that its size and status representations in SAM are current, accurate and complete as of the date of the offer for the subcontract. This will allow subcontractors to maintain their size and status representation in one location and reduce paperwork and administrative burden placed on prime contractors.

Please do not hesitate to contact Jon Williams or Kathryn Flood at (202) 857-1000 if you have any questions about these comments.

Sincerely,



Jonathan T. Williams
Kathryn V. Flood