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December 27, 2018

VIA FEDERAL RULEMAKING PORTAL

Mariana Pardo
Director, HUBZone Program
U.S. Small Business Administration
409 Third Street SW
Washington, DC 20416

Re: RIN 3245-AG38
Small Business HUBZone Program; Government Contracting Programs

Dear Ms. Pardo:

We are writing to submit comments on the U.S. Small Business Administration's ("SBA") above-referenced proposed rule regarding changes to the Historically Underutilized Business Zone ("HUBZone") Program. According to the notice of this rulemaking in the Federal Register, these comments are timely submitted by December 31, 2018. See 83 Fed. Reg. 54812 (Oct. 31, 2018).

Our firm represents government contractors, and many of these companies participate in or work with small businesses certified in SBA's HUBZone Program. In representing these firms and working with SBA over the years, we have seen both the many good things this Program can do for the targeted communities, as well as the need for improvements to the HUBZone regulations to provide greater certainty and realistic eligibility requirements. Program improvements are greatly needed at this time to build on the positive changes Congress has made to the Program in recent years and to reverse the declining federal spending on HUBZone set-asides over the last decade.

For these reasons, we welcome the proposed comprehensive rule changes for the HUBZone Program and urge SBA to implement the final rule as quickly as possible. We applaud SBA for its recognition that the current requirements are "ambiguous" and "unrealistic," and for SBA's efforts to address these concerns through new rules that will provide greater certainty and realistic ability for HUBZone firms to maintain compliance. It is clear that SBA thoughtfully developed this rule, and we appreciate the agency's overarching goal and commitment to improving the HUBZone Program.

Our further comments on the proposed rule are as follows:

❖ **SBA's Changes to the Recertification Process Are Beneficial**

We applaud SBA for implementing an annual recertification requirement for HUBZone Program participants rather than making firms essentially reapply every three years. We also think it makes good sense for a HUBZone firm's eligibility for a HUBZone set-aside to relate back to its most recent certification or recertification date. This change will enable more HUBZone firms to remain in compliance while they pursue and win new contracts, bringing financial benefits to the HUBZone in question.

Additionally, as we read amended Section 126.500, the annual recertification submission will be a written recertification by the HUBZone firm of its continued HUBZone eligibility and, only upon SBA's request, would firms be required to provide supporting documentation. We support this straightforward recertification process and believe it aligns with SBA's other programs whereby a participant's self-certification may be challenged through the protest process.

❖ **SBA's Proposed Changes to the "35% Requirement" Are Welcome**

SBA has proposed to clarify the requirement that 35% of a HUBZone firm's employees must reside in a HUBZone (the so-called "35% requirement") in several ways, all of which assist HUBZone Program applicants and participants in better understanding how to comply with the HUBZone regulations. First, SBA has proposed that an employee who resides in a HUBZone at the time of a HUBZone small business concern's certification or recertification shall continue to count as a HUBZone employee as long as the individual remains an employee of the firm, even if the employee moves to a location that is not in a qualified HUBZone area or the area where the employee's residence is located is redesignated and no longer qualifies as a HUBZone. Previously, this was often a complex and complicated issue for employers and employees alike operating within the HUBZone Program to satisfy. Employees may change residences after they start working, and it can difficult for an employer to maintain its HUBZone status if a number of employees move from HUBZone residences to non-HUBZone residences. This proposed change, in conjunction with the freezing of the HUBZone maps, will further increase stability and reliability for businesses participating in the HUBZone Program and will ultimately result in more resources being redistributed back into HUBZone communities. Second, SBA proposed to clarify that all employees are counted when determining a concern's compliance with the 35% requirement, regardless of where the employee performs his or her work. Although many HUBZone firms already understood this to be SBA's intention behind the 35% requirement, the proposed rule would eliminate any uncertainty with respect to how to determine whether a firm is compliant with the 35% requirement.

Lastly, SBA also proposed to change its application of how SBA requires a firm to meet the 35% requirement when the calculation results in a fraction by rounding "to the nearest whole

number," rather than rounding up in every instance. This proposed change is extremely beneficial because the previous practice of rounding up would have unnecessarily precluded some firms from participation in the HUBZone Program simply due to rounding up a fraction. SBA's proposed rule will result in more firms being eligible for the HUBZone Program and will more accurately reflect firms' actual composition of HUBZone and non-HUBZone employees.

- **Freezing the HUBZone Maps Gives Firms Greater Certainty**

The proposed rule reiterates that SBA has frozen the HUBZone maps with respect to qualified census tracts, qualified non-metropolitan counties, and redesignated areas until December 31, 2021. We applaud and support SBA's decision to freeze the HUBZone maps because it will increase HUBZone firms' ability to rely on the HUBZone-designated areas and develop long-term business plans based on investing more resources into cultivating a workforce that will directly benefit those geographic communities. Prior to freezing the maps, HUBZone firms had less certainty about whether they could remain in the HUBZone Program if the location of their principal office suddenly became a redesignated HUBZone. And, although the redesignation period is three years, having the security of knowing that all current HUBZones will remain HUBZones until at least December 31, 2021, affords current participants in the HUBZone Program the ability to plan for the future.

- **SBA's Proposed Definition of "Principal Office" Adds Necessary Clarity**

SBA has proposed to amend the definition of "principal office" to eliminate ambiguities in the regulation by counting all employees of the concern, other than those employees who work at jobsites, which includes both HUBZone residents and non-HUBZone residents. SBA has also proposed that, in order for a location to be considered a concern's principal office, the concern must demonstrate that it conducts business at this location. These clarifications will assist HUBZone Program applicants and participants to better understand what is required for an office to be considered the "principal office." Also, these clarifications, particularly the requirement that a concern demonstrate that it actually conducts business at its "principal office," will help to prevent fraud and abuse and ensure that HUBZone firms actually are investing in their local communities as the HUBZone Program was designed to accomplish.

- **We Applaud SBA's Proposal to Allow Requests for Reconsideration**

SBA proposes to allow firms that have been denied admission to the HUBZone Program to file a request for reconsideration of that decision, and we applaud this proposal. While SBA surely attempts to process HUBZone applications properly, there are occasionally times when SBA may mistakenly deny a firm admission to the HUBZone Program. Allowing a firm to submit a request for reconsideration will allow SBA to correct a mistaken denial of an

application without the applicant having to submit an entirely new application. And this procedure would be consistent with SBA's other small business programs, such as the Section 8(a) Business Development Program. We suggest that SBA also consider allowing a request for reconsideration procedure for decertification decisions. If SBA did adopt such a procedure for decertification, we recommend that SBA allow firms to remain in the HUBZone Program while the reconsideration request is processed.

- **SBA Should Carefully Consider Changes to the Definition of "Employee"**

SBA proposes to amend the definition of "employee," which changes largely provide welcome clarification for HUBZone firms. For example, SBA's proposal to replace the requirement for the employee to work "a minimum of 40 hour per month" with "a minimum of 40 hours during the four-week period immediately prior to the relevant date of review" makes good sense considering pay periods are commonly calculated in weeks, not months. We believe this change will make it easier for HUBZone firms to calculate compliance.

We also appreciate SBA's recognition that an owner who works for his or her HUBZone firm should count as an employee, depending on how many hours he or she works and whether there are other employees. Further, SBA's proposed clarification that an individual counts as an employee for HUBZone purposes if the individual counts as an employee for size purposes is consistent with Size Policy Statement No. 1. SBA's clarifications as to in-kind compensation and SBA's proposal to continue counting individuals who receive in-kind compensation as employees make sense since in-kind compensation provides benefits with financial value to the individual and, ultimately, the HUBZone.

However, other changes SBA contemplates would pose undue burden on HUBZone firms. First, SBA seeks comments on whether the requirement instead should be changed to 20 hours per week. We believe such a change would stifle HUBZone firms, particularly new companies that are still building a portfolio of contracts. Plainly stated, a new HUBZone firm with no contracts or very few contracts will not be able to fully engage employees for 20 hours a week. And, without active contracts and revenues, these HUBZone firms would not have the ability to provide these employees monetary compensation.

Second, and relatedly, we urge SBA not to amend the definition of "employee" to count only full-time employees or full-time equivalents. Such a requirement would be too onerous for HUBZone firms, which already face difficulties recruiting employees in HUBZone areas (as SBA recognizes in its amendment of the definition of "attempt to maintain"). And, again, there are increased costs associated with full-time employees that some HUBZone firms simply cannot sustain.

SBA also seeks comments on whether seasonal employees should count as "employees." We are sensitive to SBA's concerns about abuse of the HUBZone Program, but also know that there are firms that rely on seasonal employees for their business. We suggest that SBA allow seasonal employees to count in order to enable such firms to participate in the HUBZone Program. Further, we suggest that SBA allow firms to select their certification date, which will allow firms with seasonal employees to designate a certification date following a four-week period when seasonal employees are on the firm's payroll.

Lastly, in response to SBA's request for comments, we do not think SBA should treat individuals who are employed through an agreement with a third-party business that specializes in providing HUBZone-resident employees to count for purposes of HUBZone compliance. These third-party arrangements seem as though they could be rife with abuse. Moreover, such arrangements, where an individual may only be devoting a couple of hours per month to a variety of firms, are highly unusual in the government contracting industry, where confidential information is closely guarded and employees are not shared. Additionally, it is unlikely that these employees are gaining substantive experience from such arrangements, calling into question whether this furthers the goals of the HUBZone Program.

By and large, we believe SBA's changes to the definition of "employee" will benefit participants in the Program, and other changes SBA contemplates are unnecessary or potentially harmful to participants.

- **SBA Should Address How It Will Determine Affiliation and Employee Counts for Entity-Owned HUBZone Firms**

We agree with SBA's rule issued earlier this year that permits HUBZone firms to be indirectly owned by U.S. citizens. The ability for entity-owned firms to participate in the HUBZone Program opens up more flexibility in corporate structuring and investment options for HUBZone firms, which we think will be beneficial to HUBZone firms, the HUBZone Program, and the HUBZones in which HUBZone firms are located.

One question we have is how SBA will treat the employees of "sister" and "parent" companies for entity-owned HUBZone firms. SBA's rules state that HUBZone firms may have affiliates, and such sister and parent entities would be considered affiliates. SBA's rules further state that whether the employees of the affiliates are counted as part of the HUBZone firm's employees depends on the totality of the circumstances. We believe HUBZone firms and practitioners would benefit from greater clarity from SBA on how the agency will assess the totality of the circumstances for entity-owned HUBZone firms in this scenario.

In our view, a key circumstance that should be accounted for here is that SBA rules now explicitly permit entity ownership of HUBZone firms. Therefore, we believe SBA's default approach should be not to count the employees of parent and sister entities as part of the

HUBZone subsidiary's employees, so long as the entities operate independently with shared resources, facilities, and personnel only insofar as would be typical and expected between parent and subsidiary entities. It would defeat the purpose of permitting entity ownership only to find that the parent entity's employees must always be counted with the HUBZone subsidiary's employees because the parent entity may provide typical parent company functions such as shared accounting and legal support and a common office space. There could be a situation where the HUBZone subsidiary is not sufficiently independent from the parent or sister company from an operational standpoint, and it may be appropriate to aggregate the employees of all firms in that scenario. But if the entities are largely operationally independent, and share services and personnel in a customary way for corporate families, we believe SBA should look only at the employees of the HUBZone subsidiary in determining HUBZone compliance.

- **SBA's Proposed Changes to the Definition of "Attempt to Maintain" Require Further Modification**

SBA has proposed to add further clarification to its definition of how a HUBZone firm can "attempt to maintain" its HUBZone status after award of a HUBZone contract. While we understand why SBA proposed to add further clarification as to what constitutes attempting to maintain HUBZone status, SBA's proposed definition of "attempt to maintain" is unnecessarily rigid. SBA proposes a definition that says that a firm awarded a HUBZone contract is not attempting to maintain its HUBZone status unless at least 20% of its employees reside in a HUBZone. This proposed minimum for HUBZone employees will make it much more difficult for a HUBZone firm to maintain its HUBZone status after award of a HUBZone contract.

As noted above, we applaud SBA's proposal to require HUBZone firms to demonstrate compliance with HUBZone requirements on an annual basis, instead of at the time firms submit proposals for HUBZone contracts and at the time of award. However, under SBA's proposed definition of "attempt to maintain," a firm that is awarded a HUBZone contract would then be required to immediately meet the requirement that at least 20% of its employees reside in a HUBZone. This could be difficult if the contract requires performance in an area with few or no nearby HUBZones, meaning that there would be few employees working on the new contract who could reside in a HUBZone. Imposing such a rigid definition for what constitutes attempting to maintain HUBZone status may mean that many HUBZone firms will become ineligible for the HUBZone Program by being awarded HUBZone contracts. This seems contrary to the intent of the requirement in the Small Business Act to "attempt to maintain" the 35% requirement during contract performance. See 15 U.S.C. § 632(p)(5)(A)(II).

Additionally, SBA's proposed consequences for falling below the proposed 20% minimum threshold are unnecessarily exacting. SBA proposes that, when a firm with a HUBZone contract falls below 20% HUBZone employees, SBA will propose the firm for decertification. Then, the firm could continue in the HUBZone Program if it demonstrates both

that it continues to have at least 20% HUBZone employees and that it continues to attempt to hire additional HUBZone residents to reach the 35% requirement. However, this rule provides no ability for a firm to actually demonstrate it is attempting to maintain its HUBZone status unless it employs at least 20% HUBZone employees. Instead of such a strict rule that would likely result in many HUBZone firms being decertified, SBA should maintain the current reasonableness standard by which a HUBZone firm can demonstrate it is attempting to maintain the HUBZone requirement based on the circumstances of its HUBZone contract and its attempts to recruit HUBZone employees.

Although we believe the 20% floor for attempting to maintain status is too rigid, if SBA wishes to have some minimum threshold during HUBZone contract performance, SBA should keep the definition of "employee" as someone who performs at least 40 hours of work in a four-week period. If SBA were to require HUBZone firms to maintain at least 20% HUBZone employees and those employees had to work 20 hours per week to be an "employee," many more HUBZone firms would be decertified from the HUBZone Program. These two proposed rules in concert likely would harm the HUBZone Program by excluding many firms that currently comply with the HUBZone regulations.

- **SBA Should Reconsider the Definition of "Reside"**

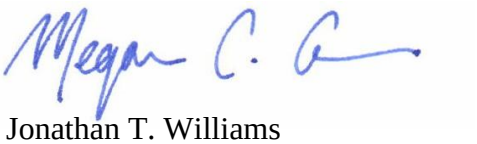
While we agree that SBA should not require an employee to demonstrate an intent to live somewhere indefinitely, we believe that SBA should give an employee the option of demonstrating an intent to live somewhere indefinitely when the employee has not lived in the HUBZone location for at least 180 days prior to the relevant date. We have worked with many clients who wish to provide financial and other incentives to their employees if they are willing to move into a HUBZone. We also know that the transient nature of employees requires HUBZone firms to be regularly on the lookout for new HUBZone employees. It would be too restrictive for HUBZone firms if they are not able to count an employee who has recently moved into the HUBZone within six months of the relevant date. Indeed, with SBA now moving to annual recertification, a firm would be unable to encourage an employee to move into a HUBZone or to hire someone who recently moved into a HUBZone once the firm is more than six months into its program year.

In the past, SBA has permitted firms to count employees who have lived in a HUBZone for less than 180 days if the employee can demonstrate an intent to live in the HUBZone indefinitely. While the proposed rule indicates that this can be difficult to judge, we believe that proof of a mortgage statement or a lease with a term extending beyond the firm's upcoming annual recertification date would be sufficient for SBA to confirm that the individual intends to remain in the HUBZone. Allowing employees to make this showing would avoid discouraging firms to incentivize employees to move to a HUBZone and would not unfairly penalize companies that hire individuals regardless of how recently the individual has moved to a

HUBZone. Therefore, we recommend that SBA revise the definition of "reside" to provide for this flexibility, such as by stating that "reside means to live at a location full-time and for at least 180 days immediately prior to the date of application or date of recertification, as applicable, or for less than 180 days if the individual demonstrates an intent to remain living at that location indefinitely."

Please do not hesitate to contact the undersigned at (202) 857-1000 if you have any questions about these comments.

Sincerely,



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