

SBA Proposal Materially Alters Contractor Recertification

By **Sam Finnerty** (September 13, 2024)

Last month, the Small Business Administration issued a proposed rule that would significantly change a government contractor's obligations to recertify its size and socioeconomic status under set-aside contracts and the effect of such recertifications.[1]

The rule affects eligibility for set-aside contracts, significantly alters the landscape for mergers and acquisitions in the government contracts industry, and could have other unintended downstream consequences.

Historically, size and socioeconomic program status recertification have been addressed in separate parts of the SBA's regulations (Part 121 for size; Part 124 for 8(a); Part 126 for HUBZone; Part 127 for women-owned small business; and Part 128 for service-disabled veteran-owned small business). The SBA tweaked these rules many times over the years, and the changes have not always been consistent, leading to obvious and material differences in the regulatory text.

However, as outlined in the rule, the SBA believes the recertification rules should be the same for size and status across all small business programs. As such, the SBA is proposing to delete the different rectification rules and consolidate them into a single regulation at Title 13 of the Code of Federal Regulations, Part 125.12.

Critically, this consolidation is not a simple housekeeping matter. Instead, the SBA is proposing material changes to its rules to overcome several recent decisions from the U.S. Government Accountability Office and the SBA's Office of Hearings and Appeals, which, according to the SBA, adopted incorrect interpretations of the SBA's rules.

Contractors that have relied on the plain text of the SBA's recertification rules and the GAO and OHA interpretations of the same should pay particular attention to the SBA's proposal.

Generally speaking, the SBA's regulations provide that a contractor's size and status, with certain exceptions, are determined at the time of initial offer (including price) and that a contractor maintains its size and status for the life of a contract, including for orders issued thereunder.

As it relates here, the SBA's recertification rules indicate that when certain triggering events occur — e.g., when a small business contract is novated, when a small business undergoes a merger, sale or acquisition, or prior to the expiration of a long-term contract's initial five-year period — a contractor must recertify its size and socioeconomic status, as applicable, to the procuring agency.

The rule plainly states that if a contractor recertifies as other than small or no longer the applicable status, the procuring agency cannot take small business or socioeconomic credit from that point forward. However, the current rules do not expressly preclude a contractor that recertifies as other than small or no longer the applicable socioeconomic status from receiving future orders set aside under its preexisting multiple award set-aside contracts.



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The GAO and OHA have found that despite such a recertification, a contractor remains eligible for pending and future set-aside task orders issued under its preexisting indefinite delivery, indefinite quantity contracts. The SBA disagrees with those decisions.

As a result, the SBA is proposing to rewrite the regulation to distinguish between "qualifying" and "disqualifying" recertifications and to make clear what the effect is of a disqualifying recertification. According to the rule, a concern must recertify:

1. "[W]ithin 30 calendar days of an approved novation, merger, acquisition, or sale, including agreements in principle, of or by a concern or an affiliate of the concern, which results in a change in controlling interest." This is significant, as the current rule requires recertification within 30 days of the transaction being finalized rather than 30 days of an agreement in principle being reached. Because the date an agreement in principle is reached is subject to interpretation, the proposed rule would make it harder for contractors to determine exactly when they must recertify.
2. "[N]o more than 120 days prior to the end of the fifth year of the award [for a contract exceeding five years], and no more than 120 days prior to exercising any option thereafter."
3. "[W]here the contracting officer explicitly requires concerns to recertify their size or status in response to a solicitation for a set aside or reserved order or agreement."

A disqualifying recertification occurs when a contractor recertifies as either other than small or other than a qualified small business program participant that is required for eligibility to participate in a set-aside or reserved award. According to the rule, the effects of a disqualifying recertification are as follows:

1. Eligibility for future task orders: If a concern has a disqualifying recertification, aside from a CO request for recertification on a specific order or agreement, the concern is ineligible to submit an offer for a set-aside or reserved order under a multiple award contract after the triggering event occurs. This is a material change from the current rules. However, the concern remains eligible for unrestricted orders issued under multiple award contracts and orders issued under single award set-aside contracts.
2. Eligibility for pending proposals: If the novation, merger, acquisition or sale triggering a disqualifying recertification occurs within 180 days after the date of an offer but prior to award, the concern is ineligible to receive the pending small business set-aside or reserved award. If such event occurs 180 days after the date of an offer but prior to award, the concern is eligible to receive a pending single award or reserve. However, where the underlying award is a multiple award small business set aside or reserve, the concern is ineligible for the pending award because the concern would not be eligible for set-aside orders issued thereunder.
3. Effect on eligibility for options: If a concern has a disqualifying recertification, aside from a contracting officer request for recertification on a specific order or agreement, the concern remains eligible to receive options under single award set-aside or reserve awards and unrestricted awards. The concern is ineligible to receive options under multiple award small business set-aside or reserve awards. This is a material change from the current rules.
4. CO recertification request: If a concern has a disqualifying recertification in response to a CO 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.

The material changes the SBA is proposing would have significant effects. Below are some key takeaways to consider.

Takeaways

No More FSS Exceptions

SBA regulations have an exception for GSA Federal Supply Schedule contracts, which provides that size and status for orders and agreements issued thereunder are generally determined as of the date of offer for the underlying FSS contract. The proposed rule eliminates this exception, meaning that if a triggering event for size or status recertification occurs, status would be determined either as of the date of the event or, in the case of a CO recertification request for a set-aside order or agreement, as of the offer date for the order or agreement.

Impact on M&A Market

The rule would significantly alter the M&A market for small business government contractors.

As it stands, a contractor remains eligible for options under set-aside contracts despite making a disqualifying certification. Moreover, under the current rules, there are situations where a contractor remains eligible for future orders set aside under its pre-existing multiple award contracts despite making a disqualifying recertification.

These rules make it possible for larger companies to acquire small businesses and perform their small business contracts for some period of time into the future. In turn, this increases the market value of small businesses and creates opportunities for divestiture.

However, the proposed rule would make it impossible for a company to acquire a small business contractor and continue pursuing task orders set aside under the acquired concern's multiple award contracts or performing the options available under those contracts after making a disqualifying recertification.

The impact of this change could be significant. Indeed, the rule could result in the acquisition value of small business contractors diminishing greatly, as the runway for set-aside contract performance is greatly reduced by the proposed changes made to the recertification rules.

This could make it more difficult for small businesses to successfully go to market prior to exceeding their size standard and could cause more small businesses to unwittingly cross into the valley of death that is the mid-sized market, where it is exceedingly difficult to compete and succeed.

Discouraging Small Businesses From Acquiring Small Businesses

Because recertification is required from both the acquiring and acquired concern, in the case of an acquisition, the rule would also affect a small business acquirer's set-aside contracts, as the acquirer would not be eligible for options or orders under its preexisting multiple award set-aside contracts if it acquired another small business and the combined business made a disqualifying certification. As such, the rule could discourage small to small business acquisitions.

Potential Increase in Off-Ramping Provisions

Because the rule makes a contractor ineligible for new orders under set-aside multiple award IDIQs after making a disqualifying recertification, procuring agencies may be more inclined to insert off-ramping provisions in the next generation of large IDIQs. Off-ramping provisions require a contract to be terminated for convenience if, for example, the contractor is acquired or makes a disqualifying recertification.

Protests to Enforce the Rule

The rule would allow requests for size determinations following any recertification made under the new consolidated recertification rule as well as those requested by a CO. The rule also explains that in connection with a size recertification relating to a multiple award contract, any contract holder on that contract can request a formal size determination concerning a recertifying concern's status as a small business.

Policing Affiliates

Under the rule, if a triggering event occurs to the small business concern or one of its affiliates, recertification will be required. Thus, not only will small businesses need to be tracking their own mergers, sales, acquisitions and novations, they must do the same for all of their affiliates.

Next Steps

Comments on the rule are due by Oct. 7.

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[1] <https://www.federalregister.gov/documents/2024/08/23/2024-18325/hubzone-program-updates-and-clarifications-and-clarifications-to-other-small-business-programs>.