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2016 NDAA Makes Critical Changes To Small Business Government Contracting Program

Late last month Congress enacted and the President signed the 2016 National Defense Authorization Act (the “2016 NDAA”) (Pub L. No. 114-92) and, as has been the case with the annual National Defense Authorization Acts in recent years, the 2016 version contains several provisions that tweak the Small Business Administration’s (“SBA”) government contracting programs and rules.

Non-Manufacturer Rule Clarification

The 2016 NDAA amended the Non-Manufacturer Rule (15 U.S.C. § 637(a)(17)) (the “NMR”) to clarify that the NMR applies only to contracts that are principally for supplies and that it does not apply to those contracts that are primarily for services or construction but that also may have a supply component. The upshot of this change is that small businesses will find it easier to bid on services and construction contracts as they will not need to meet the requirements of the NMR for these types of contracts. This clarification follows a virtual tug-of-war between the Court of Federal Claims (“COFC”) and the SBA regarding the scope and the meaning of the NMR, principally focusing on the issue of whether the NMR applied only to contracts that were primarily supply contracts or whether it also applied to contracts with mixed supply and services components.

By way of background, the Small Business Act and SBA regulations contain limitation on subcontracting rules that generally require a small business contractor to perform at least 50% of the contract work itself. The NMR allows a small business primarily engaged in the retail or wholesale trade to perform a small business set-aside contract by providing supplies manufactured by another small business without regard to the limitation on subcontracting rules (provided several pre-requisites are met). Thus, the NMR is an exception to the limitation on subcontracting rules that makes it possible for a retail or wholesale small business to be awarded a small business set-aside contract when, because the small business is subcontracting most of the value of the contract to another company in order to provide the required products, it would otherwise be unable to comply with the limitation on subcontracting rules.

Prior to the 2016 NDAA’s enactment, some case law suggested that the plain meaning of the NMR required its application

to any contract that had a supply component (including services or construction contracts that also required the contractor to supply some manufactured product). In 2006, the COFC held in *Rotech Healthcare, Inc. v. United States*, 71 Fed. Cl. 393 (2006), that the NMR applied to all contracts that involved the provision of supplies, even those contracts that were primarily for services or were even classified with a services NAICS code. This interpretation of the NMR created a burden on small businesses who found it difficult to comply with the NMR when performing a services or construction contract.

In response, the SBA amended its NMR-implementing regulations (13 C.F.R. § 121.406(b)) in 2011 to reflect the SBA's position that the NMR applied only to contracts that have been assigned a manufacturing or supply NAICS code, and not to contracts assigned a services or construction NAICS code, even if the contract included a supplies component. Then, in 2014, the COFC invalidated this rulemaking in *Rotech Healthcare, Inc. v. United States*, 118 Fed. Cl. 408 (2014). In this second *Rotech* decision, the COFC reiterated its prior holding that the language of the statutory NMR was unambiguous and applied to all contracts that have a supplies component, not just to those where supplies predominate and, therefore, that the SBA did not have the power to amend the statute with an administrative rulemaking. Thus, according to the 2014 *Rotech* decision, regardless of what NAICS code was assigned to the contract or whether or not supplies predominated, if any requirement for supplies was included in the contract, the NMR applied.

The 2016 NDAA finally settled the contradictory interpretations given the NMR by the SBA and Court of Federal Claims and alleviates the burden of requiring small businesses to meet the NMR on non-supply contracts. The 2016 NDAA adopts the SBA's view that the NMR should only apply to contracts that are primarily for supplies, not ones primarily for services. The conference report expresses Congress' belief that when the NMR is applied to services and construction contracts, small businesses were unduly restricted from participation.

Consideration of Team Members' and Joint Venturers' Past Performance

The 2016 NDAA also added language to the Small Business Act that requires a procuring agency to consider the capabilities and past performance of all members of the team or joint venture to be the capabilities of the small business joint venture or prime contractor when evaluating a proposal submitted by a joint venture or teaming arrangement with a small business prime contractor for a consolidated or bundled contract. In other words, the capabilities and past performance of all members of the team or joint venture are now to be imputed to the small business prime contractor, in the case of a teaming arrangement or, in the case of a small business joint venture, to the joint venture as a whole.

Prior to this change, the Small Business Act required an agency to give "due consideration" to the capabilities and past performance of team members or joint venturers, but did not require that team members' or joint venturers' past performance be imputed to the small business prime contractor or to the joint venture as a whole. The net effect of this change is that small businesses will be better able to compete with their large business counterparts because they will be able to rely on the experience and reputation of their teaming or joint venture partners.

Changes at OHA

Section 869 of the 2016 NDAA created an Office of Hearings and Appeals to hear appeals of decisions made by the SBA. Many readers may be confused by this provision since the SBA has had an Office of Hearings and Appeals ("OHA") to handle appeals of SBA decisions since 1983. However, the pre-existing OHA was a regulatory creation of the SBA. The 2016 NDAA now gives OHA a statutory warrant and brings OHA and its jurisdiction, procedures and functions specifically under the purview of the Administrative Procedure Act ("APA"). Aligning OHA with the APA likely will not result in any noticeable changes to the practice of litigating OHA appeals as the rules governing OHA have generally tracked the rules for adjudications under the APA—there is no substantive change to OHA's jurisdiction or powers. Rather, the change is really one of statutory housekeeping making it clear that OHA appeals must follow APA rules and ensuring that any changes to the APA also apply to OHA practice as well. One cosmetic change, however, will be noticeable—OHA's "Administrative Judges" will now be designated "Hearing Officers."

The 2016 NDAA included a separate provision that added appeals of size standards to OHA's jurisdiction. Prior to this change OHA did not have the power to hear a challenge to the SBA's determination that a certain amount of revenue or number of employees should be the size threshold for a given NAICS code. Accordingly, parties wishing to challenge such a determination had to pursue a costly and time-consuming APA action in a federal district court. Now they will have recourse to the relatively inexpensive and swift OHA appeals process.

Expansion of the HUBZone Program

Section 866 of the NDAA expanded eligibility for the HUBZone Program in several important ways. First, qualified disaster areas designated by the President following a catastrophic incident are now considered HUBZones, and businesses located therein eligible for the HUBZone program. Second, companies owned by Native Hawaiian Organizations are now eligible for the HUBZone program in the same manner as companies owned by Alaska Native Corporations and Indian tribal governments. Lastly, while areas within the boundaries of military installations that have been closed (“base closure areas”) have long been considered HUBZones, the 2016 NDAA now includes areas which intersect or are contiguous to the base closure areas as HUBZones for a period of at least 8 years following the base closure, at which point the SBA can then determine whether to designate the area a HUBZone under the normal procedures based on data from the decennial census. Furthermore, companies located in the base closure areas can meet the program’s employment requirements by hiring 35 percent of their employees from the base closure area or any other qualified HUBZone.

Additional Provisions

The NDAA also included several additional, less consequential provisions including: new certification requirements for business opportunity specialists, commercial market and procurement representatives; a codification of the requirement to publish a scorecard on agency contract awards to small businesses; a requirement that the Government Accountability Office (“GAO”) report on the effectiveness of the score card methodology (sec. 868); and a requirement that each agency’s Director of Small and Disadvantaged Business Utilization serve as an intermediary between a small business bidder/offeror and the contracting official prior to the award of a contract where the small business notifies the Small and Disadvantaged Business Utilization office that it has reason to believe the contracting process has been modified to preclude a small business from bidding or to give another contractor an unfair competitive advantage.

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