

The Limitations on Subcontracting Rule: DOD makes immediate change; FAR Council issues proposed rule

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The Department of Defense (DOD) has issued a class deviation that resolves the inconsistency between the Small Business Administration (SBA) regulations and the clause at Federal Acquisition Regulation (FAR) 52.219-14 related to the Limitations on Subcontracting Rule (LOSR).

The FAR Council has also issued a proposed rule to amend FAR 52.219-14 to fully resolve this issue for all small businesses. Government contractors should be aware of these new changes and proposed changes, and public comments on the FAR Council's proposed rule were accepted on or before February 4, 2019.

The government does not want a small business to get an award, perform only a small portion of the work, and then subcontract out everything else to large businesses.

Generally, the LOSR prevents small business prime contractors from subcontracting the majority of the work under a prime contract to large businesses. The LOSR is intended to ensure that small businesses get the benefit of the set-aside prime contract. The government does not want a small business to get an award, perform only a small portion of the work, and then subcontract out everything else to large businesses.

Since 2016, SBA small businesses have struggled to comply with the LOSR because the regulations at 13 C.F.R. § 125.6 are inconsistent with the contract clause at FAR 52.219-14.

In 2016, the controlling regulation for the LOSR, found at 13 C.F.R. § 125.6, was amended to change the formula for calculating how much work a small business prime contractor can subcontract to other businesses.

After that change, for example, the regulation now states that in the case of a contract for services (except construction), a small business shall not pay more than 50 percent of the amount paid to it by the government to firms that are not similarly situated.

A similarly situated entity is a subcontractor that has the same small business program status as the prime contractor, and is

small for the NAICS code that the prime contractor assigned to the subcontract.

However, the contract clause at FAR 52.219-14, which is included in many current government contracts, states that for contracts for services (except construction), "at least 50 percent of the cost of contract performance incurred for personnel shall be expended for employees" of the small business, and makes no mention of similarly situated entities. This calculation is confusingly different from the formula contained in 13 C.F.R. § 125.6.

Therefore, small businesses have struggled with how to best implement these conflicting requirements when performing a contract or when making representations in their proposals about subcontracts.

Several contracting officers also have taken the position that FAR 52.219-14 controls because that is the clause in the contract, even though it conflicts with the law.

Two recent announcements move towards finally resolving these conflicts.

DOD CLASS DEVIATION

On December 3, 2018 (amended January 8, 2019), the DOD issued Class Deviation 2019-00003,¹ which updates FAR 52.219-14 for DOD contracts to align it with the regulations at 13 C.F.R. § 125.6.

According to the Class Deviation announcement, DOD contracting officers are immediately required to use the Class Deviation instead of the existing clause at FAR 52.219-14 when issuing solicitations and awarding contracts or task or delivery orders to small businesses, including 8(a) program participants, HUBZone small businesses, SDVOSB concerns, EDWOSB concerns, and WOSB concerns.

This Class Deviation is a welcome change for DOD contractors who now know how their LOSR obligations will be evaluated.

SBA PROPOSED RULE — PUBLIC COMMENTS CLOSED ON FEBRUARY 4, 2019

On December 4, 2018, one day after the DOD's Class Deviation was first issued, the FAR Council announced its long-awaited proposed

rule (82 Fed. Reg. 62540)² to amend FAR 52.219-14 to make it consistent with the regulations at 13 C.F.R. § 125.6.

Subcontracting to similarly situated entities

Under the proposed rule, the FAR would be updated to confirm that subcontracts to similarly situated entities will not count against the LOSR restrictions. Therefore, once implemented as a final rule, small businesses can comfortably subcontract with other similarly situated small businesses without having those subcontracts count against the LOSR calculations.

The work subcontracted to a similarly situated entity would be counted as if it were performed by the prime contractor. The proposed rule identifies a similarly situated entity as follows:

(b) *Definition.* "Similarly situated entity," as used in this clause, means a first-tier subcontractor, including an independent contractor, that has the same small business program status as that which qualified the prime contractor for the award; and is considered small for the NAICS code the prime contractor assigned to the subcontract the subcontractor will perform. An example of a similarly situated entity is a first-tier subcontractor that is a HUBZone small business concern for a HUBZone set-aside or sole-source award under the HUBZone program.

A bid protest decision³ issued by the U.S. Government Accountability Office on January 6, 2014 gives small businesses good arguments that even before these regulations are changed, subcontracting to similarly situated entities should not be considered subcontracted costs under the LOSR. However, when the proposed rule is made final, it will transform those arguments from "good" to "rock solid."

The formula for calculating LOSR compliance

The proposed rule would also resolve the current conflict between the regulations and the FAR clause related to the calculation of the amount that can be subcontracted.

For example, in the case of contracts for services (except construction), which is discussed above, the clause and the regulations would both make clear that a small business shall not pay more than 50 percent of the amount paid to it by the government to firms that are not similarly situated,

and would not require the more complicated calculation of the cost of contract performance incurred for personnel.

The FAR Council sought public comments to the proposed rule, submitted through the Regulations.gov website,⁴ on or before February 4, 2019.

While small businesses still have to wait for a final rule that implements the 2016 amendments into the FAR, DOD contractors now have immediate clarity and all other small businesses can find some hope that this proposed rule should soon be made into a very necessary final rule.

NOTES

¹ <https://bit.ly/2Bw3UKG>

² <https://bit.ly/2RRZuTG>

³ <https://bit.ly/2l7Wzqq>

⁴ <https://bit.ly/2TJ3szQ>

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