

**RECENT DEVELOPMENTS AND CHANGES AFFECTING
SMALL BUSINESS GOVERNMENT CONTRACTORS**

**1. New FAR Ethics Requirements Mandate The Disclosure of
Criminal and Civil Violations and/or Significant Overpayments**

Effective December 12, 2008, the government has amplified its existing compliance program provisions. As originally enacted at the end of 2007, the rules called upon contractors to establish a code of business ethics and related training and internal controls, although small businesses were exempted from the training and internal controls requirement. However, under the new set of additional requirements, large and small business contractors must now disclose to the Government violations of criminal law, violations of the civil False Claims Act, and certain significant overpayments in connection with the award, performance, or closeout of a government contract performed by the contractor or a subcontract awarded thereunder. More specifically, the new rule requires contractors to "timely" disclose these violations to an agency's IG and contracting officer whenever a contractor has "credible evidence" of a violation of Federal criminal law involving fraud, conflict of interest, bribery, gratuity violations, or violations of the civil False Claims Act. Unfortunately the terms "timely" and "credible evidence" are not clearly defined in the new rules. The disclosure must be made on all existing contracts and subcontracts within three years after final payment. On contracts used by multiple agencies, such as the Federal Supply Schedule, the rule requires making disclosures to the IG for the ordering agency and the IG of the agency responsible for the basic contract. In addition to making the disclosures, contractors are expected to fully cooperate with the government in matters that must be disclosed.

The new requirements also provide that a contractor may be suspended or debarred for the "knowing" failure by one of its "principals" to disclose a violation or to disclose a significant overpayment. According to the regulations, a *principal* means an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a subsidiary, division, or business segment and similar positions on the contract).

The government requires prime contractors to flow-down provisions reflecting these new requirements in all subcontracts expected to exceed \$5 million and with a performance period of 120 days or more. However, companies may be subject to debarment or suspension for failure to make appropriate mandatory disclosures regardless of whether their contracts contain the clause reflecting the new provisions.

Companies must carefully review these new requirements to determine exactly when and how they are applicable.

**2. The Small Business Set-Aside Requirements Under Part 19 of the
FAR Apply to Task and Delivery Orders Under Multiple Award
Contracts**

In a significant ruling which enhances opportunities for small businesses to receive orders under government contracts, *Delex Systems, Inc.*, B-400403, October 8, 2008, the Government Accountability Office (GAO) has held that the FAR's small business set-aside provision, also known as the "Rule of Two", applies to task and delivery orders under multiple-award ID/IQ contracts. The "Rule of Two" (FAR 19.502-2(b)) essentially requires that an agency set-aside an acquisition over \$100,000.00 exclusively for small businesses when there is a reasonable expectation that offers will be obtained from at least two responsible small businesses at fair market prices. The government argued that the Rule of 2 should apply only to initial contract awards, but not to separate individual orders. The GAO rejected this argument and noted that since the competition *for an order* is the stage when offerors submit proposals, that is the most logical stage for contracting officers to judge the likelihood of receiving two fair market offers from small businesses. Therefore, the GAO rejected the government's position and recommended that the procuring agency make a determination of whether there is a reasonable expectation that it will receive offers from two small businesses at a fair market price, and if the agency's research indicates that these conditions are met, it should reissue the order as a small business set-aside.

This ruling has the potential of vastly expanding the potential opportunities for small businesses under multiple-award IDIQ contracts. However, it is unclear if the ruling will extend to request for quotes under the GSA schedules which may not be subject to the set-aside requirements under Part 19 of the FAR.

**3. The SBA Rule Establishing Affiliation Between Small and Large
Businesses Through Negative Control Is Relaxed By the Office of
Hearings and Appeals**

Under the SBA regulations, small businesses may be deemed "affiliated" with large companies, and thereby lose their status as small businesses, when the later has the ability to exercise "affirmative or negative" control over the small business. Examples, of negative control include instances when as a minority shareholder, a large business has the ability under the company's bylaws or a stockholder's agreement to prevent a quorum or otherwise block action by the board of directors or shareholders. However, a recent decision by the Office of Hearings and Appeals (OHA) of the U.S. Small Business Administration (SBA) confirms that the SBA affiliation rules do not automatically prohibit a stockholder's agreement that allows for "negative control" by minority shareholders through a supermajority approval requirement for certain fundamental corporate transactions that are "outside the ordinary course of business" such as amending the corporate charter or bylaws, issuing additional shares of stock, or changing the nature of the business. In the recent case, *Size Appeal of EA Engineering, Science and Technology, Inc.*, SBA No. SIZ-4973 (July 14, 2008), OHA declined to support a de facto prohibition upon supermajority voting requirements, regardless of the degree of control they entail, because such a prohibition "would create a chilling effect on a small concern's access to capital from large institutions that would be willing to provide such financing on the condition that they retain some control over certain fundamental corporate transactions".

Hopefully, this relaxation of the negative affiliation rule will make it easier for small businesses to obtain financing from entities that are not interested in controlling the daily operations of the small business, but who have a legitimate interest in retaining the ability through supermajority voting requirements to limit some extraordinary corporate actions.

**4. HUBZone Firms Can Now Get Preference For Set-Asides Over
SDVOSB Firms**

In a recent ruling, *International Program Group, Inc.*, B-400278, (September 19, 2008), the GAO held, that before proceeding with a procurement set-aside for a service-disabled veteran-owned small business concern (SDVOSBC), an agency must first reasonably consider whether the conditions for a HUBZone set-aside exists. These conditions include whether the agency will receive offers from at least two HUBZone concerns and award will be made at a fair market price to such a concern. If those conditions are met, the agency is required, according to the GAO, to issue the procurement as a HUBZone set-aside. The GAO reached this decision based on its comparison of the statutory and regulatory language implementing the HUBZone and SDVOSB programs. The applicable provisions *mandate* a HUBZone set-aside when there is a reasonable expectation that offers will be received from two or more HUBZone firms and that award will be made at a fair market price. In contrast, as the GAO noted, the legal authority implementing SDVOSBC set-asides indicates that discretion is given to contracting officers with respect to using such set-asides. Therefore, according to the GAO, the discretionary authority to use the SDVOSB program is trumped by the mandatory nature of the HUBZone set-aside program.

The decision clearly strengthens the argument that HUBZone program set-asides should be given priority over SDVOSB set-asides and, possibly, other set-aside programs.

If you need any additional information concerning these new requirements, or other issues relating to government contracting, you can contact **Ken Brody of David, Brody & Dondershine, LLP at 703-264-2220 or KBrody@dbd-law.com.**

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