

# PRATT'S GOVERNMENT CONTRACTING LAW REPORT

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# Small Business Administration Proposed Rule Would Enact Material Changes and Promote Regulatory Uniformity Across Size and Status Programs—Part II

*By Olivia Lynch, Michael E. Samuels and Zachary Schroeder\**

*In this two-part article, the authors discuss a proposed rule posted by the Small Business Administration (SBA) to update and clarify aspects of various SBA small business programs. In the first part, which was published in the December 2024 issue of this journal, the authors reviewed proposed changes related to minority shareholder negative control rights, size and status recertifications, and the ostensible subcontractor rule. In this part, the authors review proposed changes to the 8(a) BD program, the HUBZone program, miscellaneous proposed amendments to achieve uniformity across programs, and other miscellaneous proposed amendments.*

## CHANGES TO THE 8(a) BD PROGRAM

SBA is also proposing a number of changes specific to the 8(a) BD Program, including but not limited to:

- *Ownership Restrictions Relating to Non-Disadvantaged Individuals.* Currently, a non-disadvantaged individual or another business concern in the same or similar line of business generally cannot own more than 10 percent of an 8(a) BD Participant that is in the developmental stage or more than a 20 percent interest in an 8(a) BD Participant in the transitional stage of the program. The proposed rule would increase (via 13 C.F.R. 124.105(h)(2)) those allowable ownership percentages from 10 and 20 percent to 20 and 30 percent.
- *Change in Ownership.* Currently, a Participant may generally change its ownership or business structure so long as one or more disadvantaged individuals own and control it after the change and SBA approves the transaction in writing prior to the change. There are certain limited exceptions (in 13 C.F.R. 124.105(i)(2)) where only notice to SBA is required (as opposed to receiving SBA consent pre-transaction), including where all the non-disadvantaged owners own no more than a 20 percent interest in the concern both before and after the transaction; the transfer results from the death or incapacity due to a serious, long-term illness or injury of a disadvantaged principal; or the

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disadvantaged individual or entity in control of the Participant will increase the percentage of its ownership interest. SBA is proposing to amend this regulation (at 13 C.F.R. 124.105(i)) in two ways: first, prior approval would only be required where a non-disadvantaged individual owns more than a 30 percent interest in the 8(a) Participant either before or after the transaction; and, second, if the 8(a) Participant has never received an 8(a) contract, approval would not be required.

- *Loosening of Application Requirements Concerning Demonstration of 2 Years of Operating Revenue.* Currently, an applicant's income tax returns for each of the two previous tax years must show operating revenues in the primary industry in which the applicant is seeking 8(a) BD certification. SBA is proposing to revise the regulation (at 13 C.F.R. 124.107(a)) to merely require that an applicant's income tax returns for each of the two previous tax years must show operating revenues. This is because revenue on an income tax return may not be aligned by industry or NAICS code and SBA has determined that entities should not be excluded from the 8(a) BD Program because of tax returns not appropriately capturing information.
- *Loosening of Requirements—Good Moral Character.* Currently, SBA only requires demonstration of good character with respect to participation in the 8(a) BD Program—SBA must determine that an applicant or Participant and all of its principals possess good character (per 13 C.F.R. 124.108). While SBA is not going so far as to remove the good character requirement, the proposed rule would limit the grounds that would serve as an automatic, mandatory bar from participation in the 8(a) BD Program based on good character (i.e., either an application denied or possible termination action commenced against a current Participant). Specifically, SBA is proposing to remove the automatic bar for “possible criminal conduct” and to change the lack of business integrity bar to lack of business integrity as demonstrated by conduct that could be grounds for suspension or debarment.
- *Accepting a Requirement into the 8(a) BD Program.* Currently, SBA's regulations (at 13 C.F.R. 124.105) provide that SBA will not accept a particular requirement for award through the 8(a) BD Program where, among other reasons, the procuring activity issued a solicitation for or otherwise expressed publicly a clear intent to award a contract as a small business set-aside, or to use the HUBZone, VetCert, or WOSB programs prior to offering the requirement to SBA for award as an 8(a) contract. SBA is proposing to amend this provision to allow SBA to accept a requirement for the 8(a) Program where the Associate

Administrator of the Office of Business Development (AA/BD) determines that there is a reasonable basis to cancel the initial solicitation or, if a solicitation had not yet been issued, a reasonable basis for the procuring agency to change its initial clear expression of intent to procure outside the 8(a) BD Program. For example, SBA could accept a requirement where the procuring agency's needs have changed since the initial solicitation was issued such that the solicitation no longer represents its current need, or where appropriations are no longer available for the requirement as anticipated and the solicitation must be canceled until a following fiscal year where funds are available. On the other hand, a mere change in strategy (i.e., an agency seeks to solicit through the 8(a) BD Program instead of through another previously identified program) would not constitute a reasonable basis for SBA to accept the requirement into the 8(a) BD Program.

- *Clarification on Exercising Options Post-Exit from 8(a) Program.* Currently, under SBA regulations at 13 C.F.R. 124.514(a)(1), if an 8(a) Participant graduates or has been terminated or the entity is no longer small under the size standard corresponding to the NAICS code for the requirement, negotiations to price an option cannot be entered into and the option cannot be exercised. Apparently, SBA has received inquiries as to whether this provision equally applies to firms that have voluntarily exited the program. Since it was always SBA's intent that 13 C.F.R. 124.514 apply to all firms that are no longer active Participants in the program, SBA is proposing to specify that the provision applies to all firms whose term of participation in the 8(a) BD Program has ended or who have otherwise exited the program through any means.

## CHANGES TO THE HUBZONE PROGRAM

SBA published a comprehensive rewrite of its regulations governing the HUBZone Program in 2019. The proposed rulemaking refines the HUBZone Program following some changes imposed by the FY2018 NDAA as well as in light of questions that SBA has received since the 2019 changes.

SBA's proposed changes to the HUBZone Program regulations include but are not limited to the following:

- *Requiring Eligibility at Time of Offer.* Under the current rules, once a firm annually recertifies its HUBZone status, it generally can submit offers for HUBZone contracts for one year without being required to meet the 35% HUBZone residency and principal office requirements at the time of offer. Because SBA is concerned about abuses of the program, SBA is proposing to amend its regulations (at 13 C.F.R.

126.601) to require that a firm be both a certified HUBZone small business and one that continues to be eligible as of the date of its offer for a HUBZone contract. SBA is also proposing to clarify that as long as a firm is eligible as of the date of its offer for a competitively awarded HUBZone contract, it will be eligible for award. (SBA is proposing to amend its regulations to specify that eligibility means an approved application—unlike in the WOSB Program, a pending application is not sufficient.) The exception is for HUBZone sole source awards for which a firm's HUBZone eligibility will be measured as of the date of award.

- *Removal of Annual Certification in Lieu of Triannual Recertification.* Currently, the HUBZone rules require firms to annually recertify their HUBZone status to SBA. SBA considered maintaining an annual recertification requirement but found that the annual recertification requirement does not fulfill the purposes of the HUBZone Program as effectively as requiring firms to be eligible at the time of offer for HUBZone contracts (discussed above). As such, SBA is proposing to amend its regulations (at 13 C.F.R. 126.500) to require triannual recertification. This brings the HUBZone Program in line with the WOSB and VetCert Programs.
- *Clarifying Certification Timing for the “Attempting to Maintain” Requirement.* SBA is proposing an amendment concerning the requirement for HUBZone firms to certify that they will attempt to maintain compliance with the 35% HUBZone residency requirement during the performance of a HUBZone contract (at 13 C.F.R. 126.200(e)). SBA would require firms to make this certification when they apply for HUBZone certification, at the time they complete their recertification, and at the time of offer for any HUBZone contract.
- *Providing a Grace Period for the “Attempting to Maintain” Requirement.* Currently, a HUBZone firm can have less than 35% HUBZone residents at the time of its annual recertification if the firm is performing a HUBZone contract. SBA is proposing to amend its regulations (at 13 C.F.R. 126.500) to instead provide for a “grace period” after award of a HUBZone contract during which time the firm can take the necessary steps to hire enough HUBZone residents to get back up to 35% HUBZone residency. SBA is proposing a 12-month grace period following award of a HUBZone contract. After such grace period, the firm would have to be back up to 35% HUBZone residency at the time of any recertification.
- *Revising Definition of an “Employee”—Increasing the Minimum Hours*



*Requirement.* SBA is proposing to revise the applicable definition of employee (at 13 C.F.R. 126.103) to increase the number of hours that an individual must work to be considered an employee for HUBZone purposes from 40 to 80 hours per month. SBA believes that the minimum 40 hours per month is not sufficient to promote the purpose of the program. Moreover, SBA believes that a firm’s “principal office” should have a consistent presence of employees in the office. Allowing employees to work only 40 hours per month could result in all individuals working one week and being off the remaining three weeks. SBA has expressly stated that this change is meant to prevent abuse and strengthen the integrity of the HUBZone Program. SBA requested comments (which were due October 7, 2024) on (1) whether 80 hours per month is an appropriate threshold, (2) whether there should be a minimum number of hours per week, and (3) whether there should be an exception to the 80 hours per month threshold for a limited number (or percentage) of individuals where such individuals are working at least 40 hours per month.

- *Revising Definition of an “Employee”—Requiring Performance of Work.* SBA is also proposing to revise the applicable definition of employee (at 13 C.F.R. 126.103) to clarify the existing requirement that an individual must be performing work for the concern in order to be considered an employee for HUBZone purposes. This stems out of SBA’s 2021 discovery of firms having on their payroll HUBZone residents who did not perform work for those companies in order to claim them as employees and appear to qualify for the program. Per SBA, “[t]his has never been permitted under the HUBZone regulations because allowing this practice would undermine the purpose of the HUBZone program.”
- *Revising Definition of an “Employee”—Removal of In-Kind Compensation Employees.* SBA is proposing to revise the applicable definition of employee (at 13 C.F.R. 126.103) to delete the current ability for a company to count as an employee someone receiving in-kind compensation if the compensation is commensurate with the work performed by the individual and provides a demonstrable financial value to the individual, and if the arrangement is compliant with all relevant federal and state laws, such as federal tax laws. Per SBA, “little to no firms are able to meet these requirements.”
- *Revising Definition of an “Principal Office”—Shared Working Spaces.* SBA is proposing to revise the applicable definition of principal office (at 13 C.F.R. 126.103) for shared working spaces (or “coworking” spaces).

Firms will need to provide evidence that they have dedicated space within any shared location and that such dedicated space contains sufficient work surface area, furniture, and equipment to accommodate the number of employees claimed to work from the location.

- *Revising Definition of an “Principal Office”—Virtual Office.* SBA is also proposing to revise the applicable definition of principal office (at 13 C.F.R. 126.103) to specify that a virtual office (or other location where a firm only receives mail and/or occasionally performs business) does not qualify as a principal office.
- *Revising Definition of an “Principal Office”—Teleworking.* SBA is proposing to revise the applicable definition of principal office (at 13 C.F.R. 126.103) to add a provision that allows 100% of a firm’s employees to telework (i.e., work the majority of the time from their homes) but, where that occurs, at least 51% of its employees must work from HUBZone locations and the firm’s principal office would be the location where its records are kept. In essence, the tradeoff for not infusing capital via establishment of a principal office is that the firm would have to have 51% of its employees reside in a HUBZone instead of the normal 35%. SBA requested comments (which were due October 7, 2024) on this teleworking proposal, including whether SBA should allow teleworking employees who reside and work within the same census tract as the firm’s claimed principal office (or an adjacent census tract) to be counted as working from the principal office.
- *Decrease in Time of Proof of Residence.* SBA is proposing to amend the definition of reside (at 13 C.F.R. 126.103) to change the number of days that an individual must have lived at a location immediately prior to the relevant date of review from 180 to merely 90 calendar days.
- *Application of HUBZone Price Evaluation Preference (PEP).* SBA is proposing to amend its regulations (at 13 C.F.R. 126.613) to clarify how the PEP is applied. SBA would specify that the PEP does not apply where the initial lowest responsive and responsible offeror is a small business concern. Only if the otherwise successful offeror is a large business would the CO add 10% to that large business’s offer and, if the HUBZone’s offer is lower than the large business’s after PEP application, the HUBZone must be deemed the lowest-priced offeror.

## **MISCELLANEOUS PROPOSED AMENDMENTS TO ACHIEVE UNIFORMITY ACROSS PROGRAMS**

In line with its uniformity push, SBA has also proposed a series of changes to the various program regulations to provide better alignment concerning:

- *Eligibility for Certification into a Program.* Currently, there is great variation between status certification programs as to when an entity must be eligible. SBA is proposing to amend the 8(a) BD Program (13 C.F.R. 124.204(d)), HUBZone Program (13 C.F.R. 126.306(d)), WOSB Program (13 C.F.R. 127.304(d)), and VetCert Program (13 C.F.R. 128.302) to require consistent wording that an applicant must be eligible as of the date SBA issues a decision. SBA notes that for all certification programs, “[a]fter submitting an application for any program, a concern must immediately notify SBA of any changes that could affect its eligibility and provide information and documents to verify the changes.”
- *Qualifying Individual Responsible for Accuracy of Application.* SBA is proposing to amend or add to the regulations governing the 8(a) BD Program (at 13 C.F.R. 124.203), HUBZone Program (at 13 C.F.R. 126.302 and 126.303), WOSB Program (at 13 C.F.R. 127.301 and 127.302), and VetCert Program (at 13 C.F.R. 128.301) to provide that the individuals upon whom eligibility is based take responsibility for the accuracy of all information submitted on behalf of the applicant.
- *Determination of Small Business Status for Certification Programs.* SBA is proposing to amend the regulations governing the HUBZone Program (at 13 C.F.R. 126.200(b)), WOSB Program (at 13 C.F.R. 127.200(e)), and VetCert Program (at 13 C.F.R. 128.204(e)) to provide that, with respect to the requirement that only concerns who together with their affiliates qualify as a small business concern, SBA will accept a concern’s size representation on SAM unless there is evidence to the contrary. SBA will request a formal size determination pursuant to 13 C.F.R. 121.1001(b)(8) where any information it possesses calls into question the concern’s SAM size representation.
- *Ownership Requirements Related to Partnerships.* SBA is proposing to harmonize the provisions regarding ownership requirements pertaining to partnerships in the 8(a) BD Program (at 13 C.F.R. 124.105(b)), the WOSB Program (at 13 C.F.R. 127.202(d)), and the VetCert Program (at 13 C.F.R. 128.202(c)) “so that a firm simultaneously applying to be certified in more than one program must meet the same requirements.”
- *Right of First Refusal by Non-Qualifying Owners.* SBA is proposing to harmonize across the different statuses by allowing a right of first refusal that grants a non-qualifying individual the contractual right to purchase the ownership interests of a qualifying individual without affecting the unconditional nature of ownership, if the terms follow normal commercial practices. Currently, the VetCert Program regula-

tions address this (at 13 C.F.R. 128.202(b)(3)) but SBA is proposing to align the 8(a) BD Program ownership requirements (by adding a new 13 C.F.R. 124.105(k)) and WOSB Program requirements (by adding a new 13 C.F.R. 127.201(b)(3)).

- *Distribution of Profits.* Given a slight difference in wording as between the 8(a) BD and VetCert Program regulations on distribution of profits, SBA is proposing to align the language on distribution of profits across the 8(a) BD Program (at 13 C.F.R. 124.105(f)(1)), the WOSB Program (adding a new provision at 13 C.F.R. 127.201(g)), and the VetCert Program (at 13 C.F.R. 128.202(g)) to ensure the wording is consistent.
- *Involvement of Non-Qualifying Individuals.* While the 8(a) BD, WOSB, and VetCert Program regulations each limit involvement by non-qualifying individuals to the extent such involvement causes lack of control on the part of a qualifying individual, SBA is proposing to bring the language of each in line with the others by amending the regulations governing the 8(a) BD Program (at 13 C.F.R. 124.106(e)), WOSB Program (at 13 C.F.R. 127.202(g)), and VetCert Program (at 13 C.F.R. 127.203(h)). This would mean, for example, that just as the 8(a) BD and VetCert Programs require the qualifying individual to be the most highly compensated, now too will the WOSB Program require the qualifying woman to be the highest compensated individual in the business concern, unless the concern demonstrates that the compensation to be received by a nonqualifying woman is commercially reasonable or that the qualifying woman has elected to take lower compensation to benefit the concern.
- *S. Residency Requirement.* While the 8(a) BD Program currently requires the socially and economically disadvantaged individuals to reside in the United States (at 13 C.F.R. 124.101), there is no similar requirement for the WOSB or VetCert Programs. SBA is proposing to add a U.S. residency requirement for the qualifying individuals to the WOSB Program (at 13 C.F.R. 127.200) and VetCert Program (at 13 C.F.R. 128.200).
- *Timeline for Appealing Denials to Various Programs.* As part of the upgrade that SBA is currently doing to certify.sba.gov to create a uniform application processing system, SBA expects entities may simultaneously apply for multiple certifications for they might be eligible. As such, SBA is conforming the deadlines for when appeals would be due following a denial to the 8(a) BD Program and VetCert Program. SBA is therefore proposing to increase the VetCert deadline to

appeal a denial from 10 to 45 days (via 13 C.F.R. 134.1104) to be consistent with the current 45 days that an applicant has to appeal an 8(a) BD denial (at 13 C.F.R. 124.206).

- *Timeline for Reapplying Following Decertification.* SBA is proposing to amend the regulations governing the HUBZone Program (at 13 C.F.R. 126.309 and 126.803), WOSB Program (at 13 C.F.R. 127.305), and SDVOSB Program (at 13 C.F.R. 128.305) to eliminate the wait period for firms that have been decertified.
- *Ineligibility Based on Failure to Pay Federal Financial Obligations.* SBA is proposing to add language to the WOSB Program (at 13 C.F.R. 127.200(h)) and HUBZone Program (at 13 C.F.R. 126.200(h)) to provide that a small business is ineligible for certification if the concern or any of its principals has failed to pay significant financial obligations owed to the federal government such that these regulations would be consistent with the 8(a) BD Program regulations (at 13 C.F.R. 124.108(e)) and VetCert Program regulations (at 13 C.F.R. 128.201(b)) which currently contain such a prohibition.
- *Restrictions on Fees for Representatives of Applications to the Status Certification Programs.* While the 8(a) BD Program currently restricts such fees, SBA is proposing to create a new 13 C.F.R. 125.13 to apply to all of SBA's certification programs and impose the current 8(a) BD Program restrictions (at 13 C.F.R. 124.4).

## **OTHER MISCELLANEOUS PROPOSED AMENDMENTS**

Finally, SBA has also proposed a number of other amendments to regulations, largely clarifying various aspects of the programs:

- *New Cross-Program Basis of Removal.* As referenced above, SBA is currently undertaking creation of a uniform application processing system whereby SBA anticipates entities will be applying simultaneously for certification in multiple programs. SBA is proposing to add new provisions to each of the status certification programs to provide that a firm that is decertified or terminated from one SBA certification program due to the submission of false or misleading information may be removed from SBA's other small business contracting programs (including the SBA's Mentor-Protégé Program). In addition, the 8(a) BD Program (13 C.F.R. 124.303(c)), HUBZone Program (13 C.F.R. 126.503), WOSB Program (13 C.F.R. 127.405(f)), and VetCert Program (13 C.F.R. 128.310(g)) regulations would provide that SBA may require a firm to enter into an administrative agreement as a condition of admission or re-admission to any of the SBA's status

certification programs.

- **Clarifying that COs Cannot Restrict Competition Based on Multiple Statuses.** The various status certification programs each contain restrictions that an agency cannot restrict competition to only those entities that are certified both in the particular status as well as a second certification. SBA is proposing to clarify (at 13 C.F.R. 125.2) that a procuring activity cannot create a small business set-aside or reserve (for either a contract, order, or agreement) that requires one or more socioeconomic certifications in addition to a size certification or give evaluation preferences to concerns having one or more socioeconomic certifications.
- **Clarifying Which Contracting Officer Monitors Limitations on Subcontracting Compliance for Orders.** For multi-agency set-aside contracts under which more than one agency can issue orders, the ordering agency must use the period of performance for each order to determine compliance with limitations on subcontracting. SBA is proposing to clarify that the CO for the ordering agency is in the best position to monitor compliance and, therefore, should be the one to do so but, at the end of performance, the ordering CO also should inform the CO for the underlying MAC of any failure to meet the applicable limitations.
- **Extension to Reporting against Small Business Subcontracting Plans.** In recognition of increased burdens on prime contractors vis-à-vis order-level subcontracting reporting, SBA is proposing to extend due dates for subcontracting reports from 30 to 45 days (e.g., SF-294, Subcontracting Report for Individual Contracts would now be due November 14th as opposed to October 30th) as well as extend the time period for review from 60 to 75 days (in 13 C.F.R. 125.3).